



# Accounts Receivable Financing

## **A Planning Strategy for Business Owners Producer Guide**

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# Problems Faced By Business Owners

## 1) Accounts Receivable Balance is a Non-Performing Asset

Many clients today do not settle their bills at the time that a business provides its products or a professional performs his or her services. This is especially true in the case of service companies and medical and dental practices. It is often the case that many services are paid for using credit or insurance. Since the services have been performed but not yet paid for, this creates an account receivable. Oftentimes, a business' accounts receivable balance can be the single largest asset of the business.

A significant issue with the accounts receivable balance is that this money that the business owner is owed earns no interest and is essentially a non-performing asset. Assuming that the 90 day revolving accounts receivable balance remains fairly stable over time, it may be worth approximately the same amount years down the road as it is worth now.

## 2) Creditor Liability

In today's litigious society, creditor liability is one of, if not the biggest, issue facing business owners. This is particularly true with respect to the potential malpractice liability that many professions face. Given that the accounts receivable balance may be the single largest asset of the business, many business owners are concerned that this asset is subject to the claims of creditors. Even more disturbing is the fact that in businesses involving multiple professionals, one professional's interest in the accounts receivable balance may be adversely affected by the actions of another professional within that practice.

## 3) High Income Taxation

In general, business owners tend to have fairly high earnings, and therefore tend to have a fairly high overall income tax burden.

# Potential Benefits of Accounts Receivable Financing

Accounts Receivable Financing is a strategy that is intended to address some or all of the below problems, including:

- Transforms the accounts receivable balance into a performing asset.
- Protects the accounts receivable balance from the claims of creditors (other than the lending institution taking the primary lien against the receivables balance).
- May provide the business owner with tax-advantaged supplemental retirement income.

## Candidates for Accounts Receivable Financing

The ideal candidate for the Accounts Receivable Financing strategy is a business owner who (1) is concerned about creditor liability and (2) is interested in obtaining a tax-advantaged retirement income to supplement his or her other sources of retirement income. The strategy may be attractive even if the candidate is interested in only one of these goals (i.e., where creditor liability isn't a major issue, but there is a desire to find a source of supplemental retirement income).

Although the primary candidates for this strategy are often professionals such as medical and dental practitioners, due to their potential malpractice liability issues, any type of business owner would potentially benefit from this strategy.

It should be noted that candidates for this strategy will need to have good credit, as there is a bank loan involved that will be underwritten. In addition, since life insurance is a part of the solution, candidates will need to have a basic need for life insurance and be insurable.

## Overview of Accounts Receivable Financing

The following is a broad overview of how the Accounts Receivable Financing strategy works. Note that later sections of this guide will discuss the details of many of the different approaches used.

Accounts Receivable Financing involves using the accounts receivable balance as the primary collateral for a bank loan.<sup>1</sup> Depending on the lender used, the loan will be equal to the revolving accounts receivable balance generally ranging anywhere from 30 to 120 days. Also depending on the lender used, the loan may be equal to the entire balance (that has not otherwise been borrowed against) or the collectible balance (i.e., the unborrowed against balance less an amount representing the typical uncollectible portion). Since the bank will have a primary lien against the receivables balance, this protects the balance from the claims of other creditors.

Once the bank loan is made, the loan proceeds can be invested for the purpose of providing the business owner with death benefit protection and potentially a source of supplemental retirement income. Cash value life insurance can be ideal for this purpose for a couple of reasons. First, since creditor protection may be a major concern, individually owned life insurance may be advantageous due to the fact that it may enjoy significant protection under many state creditor protection statutes.

Clients should consult their own legal counsel as to the extent, if any, to which the accounts receivable and life insurance cash value and death benefit may be protected from creditors.

Secondly, an individually owned life insurance policy may provide the business owner with income tax advantages. One advantage is that any growth of the policy cash value will be income tax-deferred. A second advantage is that if the policy is properly designed as a non-Modified Endowment Policy (non-MEC), the business owner may be able to take income tax-free distributions from the policy.

<sup>1</sup>The entire amount of the loan proceeds are typically disbursed by the bank in the first year. In addition, the loan is interest only while outstanding and bears a competitive interest rate.

Distributions (withdrawals or policy loans) from life insurance policies treated as Modified Endowment Contracts (“MECs”) under Section 7702A of the Internal Revenue Code are subject to less favorable tax treatment than distributions from policies that are not MECs. If the policy is a MEC, distributions will be taxable to the extent there is any gain in the policy. In addition, a penalty tax of 10% on the taxable amount may also apply. Without regard to whether a policy is a MEC, any gain in the policy is taxable on full surrender of the policy.

Income tax-free distributions are achieved by withdrawing to the cost basis (premiums paid), then using policy loans. Policy loans will reduce the policy’s cash value and death benefit. Withdrawals will reduce the policy’s cash value and may reduce the death benefit. This assumes the policy qualifies as life insurance and does not lapse. If the policy lapses or is surrendered, the IRS will tax distributions received over the life of the policy and at termination that are in excess of total premiums paid.

In order to achieve some of the income tax-advantages potentially available with cash value life insurance, policy premiums will likely need to be paid over a period of several years in order to ensure that the policy is a non-MEC.

The bank making the loan will very likely require that the life insurance policy be assigned as secondary collateral to the bank. Even though in most cases the bank will look primarily to the accounts receivable balance in the event of default, the life insurance policy cash value provides a liquid source of collateral in the event the accounts receivable balance is insufficient to pay back the loan.

The loan will typically be outstanding as long as the business owner or professional is still working (i.e., until retirement). However, the loan will need to be extended from time to time, and the bank will likely do so, assuming the business owner or professional continues to be a good credit risk. Once the business owner retires, the loan agreement will generally provide that the loan must be repaid within a specified period of time. Oftentimes, the loan agreement may give up to 180 days in order to provide sufficient time for the outstanding accounts receivable to be collected. Keep in mind that the receivables, once collected, will be income taxable. Therefore, it may only be the “net” after-tax amount of the receivables that is available to repay the bank loan. To the extent that there is a deficit, the life insurance policy values or other outside funds can be used.

Once the loan has been repaid, the bank’s secondary collateral interest in the life insurance policy is released, and the business owner now owns the policy unencumbered. At this point the business owner is free to begin taking potentially income tax-free distributions from the policy cash value for purposes of supplementing his or her retirement income.

## Accounts Receivable Financing Approaches

As previously discussed in the overview of Accounts Receivable Financing, this strategy basically involves using the accounts receivable balance as collateral for a bank loan, and then using the bank loan proceeds to pay premiums into a cash value life insurance policy for the benefit of the professional. However, depending on the approach used, there may be several intervening steps between those two events. The two Accounts Receivable Financing approaches are the Personal Loan Approach and the Business Loan Approach.

## Personal Loan Approach

With the Personal Loan Approach, a bank loan equal to the participating business owner's share of the accounts receivable balance (in those cases where there are multiple business owners) is made directly to the owner. The business agrees to act as guarantor of such loan and to pledge the accounts receivable balance attributable to such owner or professional as security for its guaranty. As is discussed in more detail in the Miscellaneous Tax Issues section of this Guide, this guaranty may have some tax consequences to the business owner.

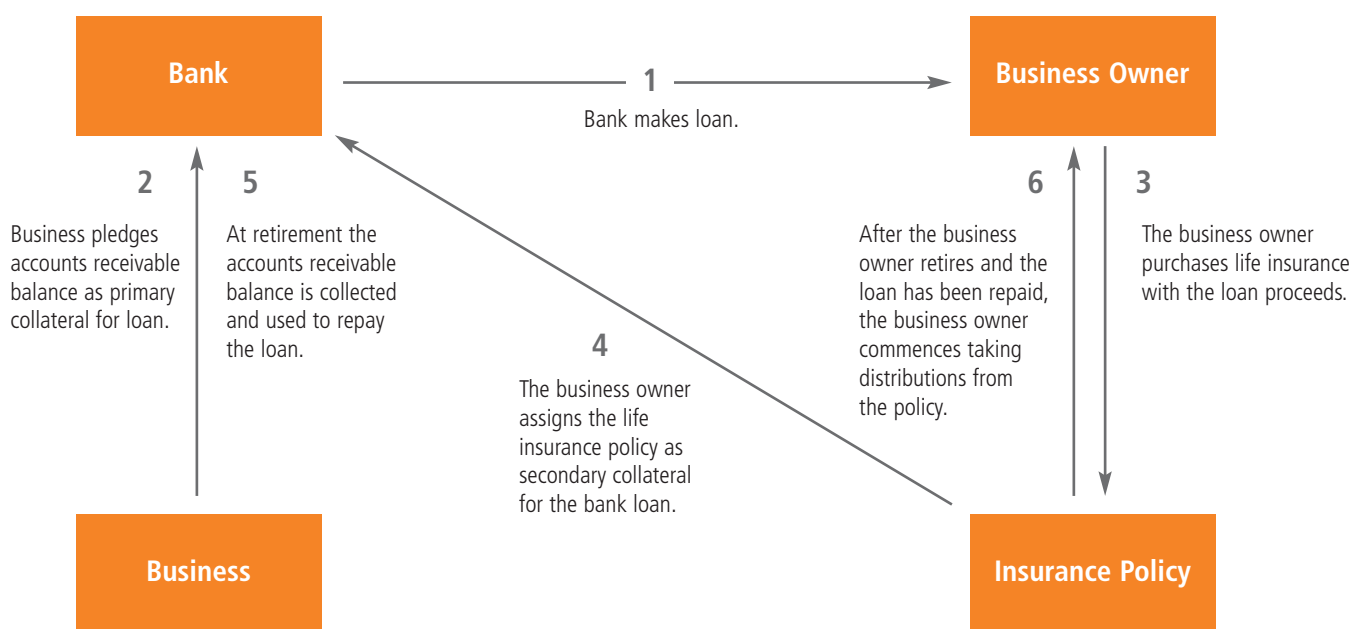
Although the business owner is generally responsible under the terms of the loan agreement for paying each year's loan interest to the bank, oftentimes the business will pay the loan interest on behalf of the owner or professional and treat it as additional compensation.

The business owner will then use the loan proceeds disbursed to him or her by the bank to pay premiums on a life insurance policy that he or she will typically own. This policy will be used as secondary collateral for the personal bank loan.

This approach is relatively simple as compared to the Business Loan Approach because one does not have to deal with the issue of how to get the loan proceeds out of the business in a tax-efficient manner. Since the loan is made directly to the business owner or professional, he or she is able to utilize the entire amount to pay premiums into the life insurance policy, and will later (after loan repayment) have access to the entire cash value for supplemental retirement purposes. This is a key advantage of the Personal Loan Approach.

A key disadvantage, aside from the potential tax ramifications of the guaranty, is that the loan interest will not be deductible. Loan interest for personal loans is generally not deductible, whereas loan interest for business loans may be deductible (see Miscellaneous Tax Issues section of this Guide for a more detailed discussion of loan interest deductibility).

The following graphic illustrates the Personal Loan Approach.

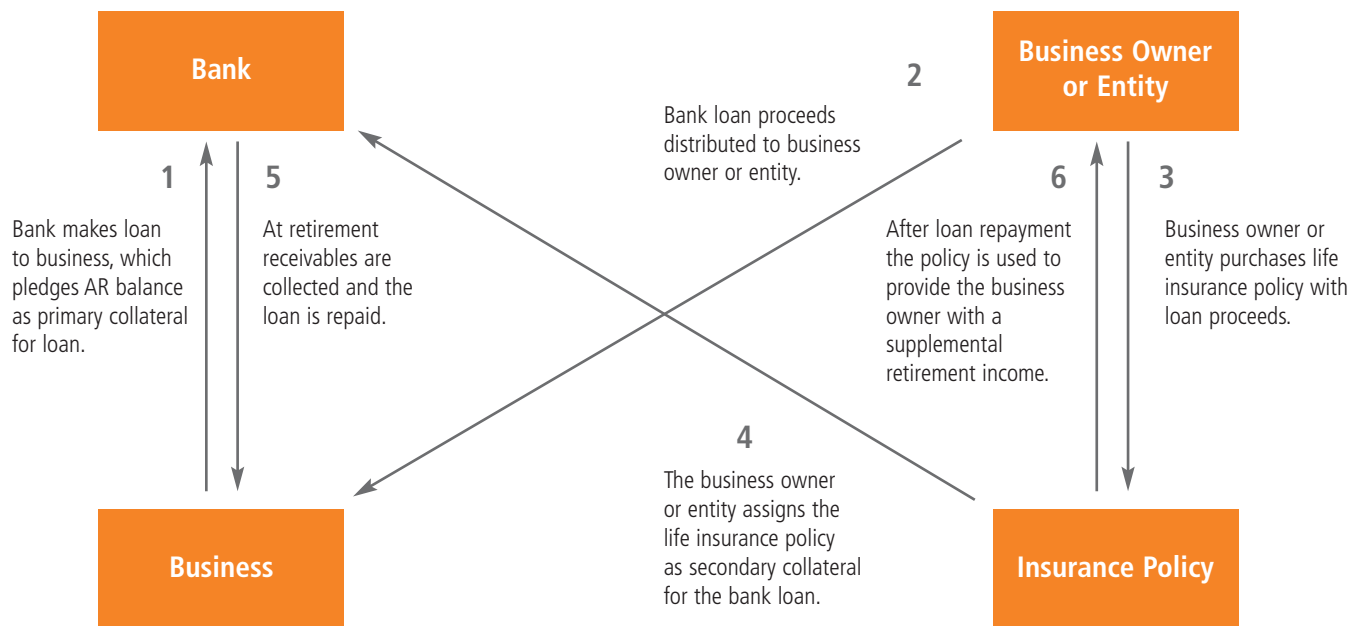


## Business Loan Approach

With the Business Loan Approach, a bank loan equal to the participating owner's share of the accounts receivable balance is made to the business. The business will pledge the owner's share of the accounts receivable balance as the primary collateral for the bank loan. Since the business is the obligor on the loan, the business will be responsible for paying the loan interest. The interest payments may be deductible by the business (see Miscellaneous Tax Issues section of this Guide for a more detailed discussion of loan interest deductibility).

Since creditor protection and tax-advantaged supplemental retirement income are two of the potential reasons for using the bank loan proceeds to pay premiums on a life insurance policy, it is best if the business doesn't own the life insurance policy. This means that the bank loan proceeds will need to be distributed in one way or another to the person/entity that will own the policy.

The following graphic illustrates a Business Loan Approach.



In order to ensure that the entire amount loaned will be available to be paid into the life insurance policy, this requires that a way be found to get the bank loan proceeds to the ultimate policyowner in a tax-efficient manner (ideally without being taxed at all). There are several different methods that have been used for this purpose, including:

- Capital distribution method
- Section 7872 loan method
- LLC investment method
- Section 83 method

## Capital Distribution Method

For tax pass-through entities such as partnerships, limited liability companies (LLCs) and S-corporations, the capital distribution method can be a simple and effective way to distribute the bank loan proceeds from the business to the owner or professional with little to no tax consequences. As long as the distribution does not exceed the owner's outside basis in the business, the distribution should be income tax-free. To the extent that the distribution exceeds the owner's basis, the distribution may be subject to capital gains taxation.

Clients should consult their own tax and legal counsel with regard to the taxation of distributions from their business.

This method works particularly well with partnerships and LLCs. This is due to the fact that if the business agreement contains the appropriate language, pursuant to I.R.C. section 752, owners of partnerships and LLCs receive a basis increase for their allocated share of the business debt. Therefore, when the bank loan is made to the business, this results in each owner's outside basis being increased by his or her share of the loan as allocated per the business agreement. This may enable the business to immediately distribute the loan proceeds to the owner with causing adverse tax consequences to the owner because the distribution should be an income tax-free return of basis.

Note that S-corporation owners do not receive a basis increase pursuant to I.R.C. section 752 for their allocated share of business debt. Therefore, in order to make a tax-free capital distribution to an S-corporation owner, he or she would have to have sufficient outside basis prior to the time that the business loan is made.

## Section 7872 Loan Method

This method involves making the bank loan to the business, which in turn makes a personal loan to the participating owner or professional. This is also sometimes known as a split dollar loan, as this arrangement is taxed under the Loan Regime of the Final Split Dollar Regulations. Since the bank loan proceeds are loaned to the business owner or professional by the business, this gives the owner the ability to use the entire amount of the funds without paying any income taxes on the loaned amount. However, the loan itself may have income tax consequences.

If the split dollar loan from the business to the owner or professional does not bear a fair market rate of interest (as determined by reference to the applicable federal rates [AFRs]), then I.R.C. section 7872 will apply. In general, section 7872 will impute compensation income to the owner or professional equal to the AFR (which is deductible to the business), and will then treat that amount as being paid to the business as interest and will impute interest income to the business owner. The end result is that the business owner or professional will end up with annual income equal to the imputed interest rate, and the tax consequences to the business will be a wash (the compensation deduction offsets the imputed interest income). Note that the business cannot deduct the interest expense, as personal interest is generally not deductible.

One disadvantage of this method is that the business now has a note receivable as a result of the split dollar loan. When the owner retires, the note will need to be dealt with. The owner could repay the note using life insurance policy cash values, but this would decrease the amount available to the owner for supplemental retirement income purposes. The business could also give the owner a bonus equal to the amount of the loan principal (this cannot be a prearranged plan, as there has to be a reasonable expectation of repayment). Although this would enable the policy cash value to remain intact, it would result in ordinary income tax consequences to the business owner or professional. Potentially, it may be possible to distribute the note to the owner as part of winding up the business or practice, with the end result that the owner may only owe capital gains tax on any excess over his or her outside basis in the business.

## LLC Investment Method

This method involves making the bank loan to the business, which in turn uses the loan proceeds to invest in a separate LLC set up by the business owner or professional. The business will assign the owner's share of the accounts receivable to the owner, who in turn will assign his or her receivables to the LLC. The LLC will manage the receivables. The LLC will use the cash invested by the owner's primary business to purchase a life insurance policy that will be owned by the LLC.

One primary benefit of this method is that the LLC itself offers limited liability. Therefore, creditor protection for the life insurance is generally achieved without regard to state creditor protection laws covering life insurance.

Another benefit of this method is that it may offer more protection for the receivables balance than the methods that rely on the bank's priority lien against the receivables balance.

A possible disadvantage of this method is that the owner or professional may not be able to take income tax-free distributions from the policy, since the business owner does not own the policy. The LLC may be able to take income tax-free distributions from the policy, but the LLC would then need to payout the distributions as compensation or possibly as a capital distribution. In either case, there may be tax consequences to the business owner or professional.

For further details regarding the LLC investment method, you will need to contact a vendor that supports this method (see Third Party AR Financing Vendor Programs section on page 10 of this Guide).

## Section 83 Method

This method involves making the bank loan to the business and then distributing the loan proceeds to the participating owner or professional pursuant to the terms of a deferred compensation agreement. The distribution is treated as a property transfer under I.R.C. section 83. Since the life insurance policy is collaterally assigned to the bank as secondary collateral for the bank loan, it is contended that this constitutes a substantial risk of forfeiture, and that pursuant to section 83, the transfer is not taxable until some later time.

The tax consequences of this method are not predictable, and as a result, this method is considered to be more aggressive than some of the others discussed in this Guide. For that reason, many of the third party vendors that support the Accounts Receivable Financing strategy do not offer this method.

NOTE: ING companies does not allow the use of its life insurance products with any Accounts Receivable Financing plan that utilizes the section 83 method.

## Miscellaneous Tax Issues

The following is a general discussion of some potential tax issues concerning the Accounts Receivable Financing strategy and should not be relied upon as tax advice. Clients should always consult their own tax and legal counsel with regard to these issues.

### Loan Interest Deductibility

A question that frequently arises concerns whether the interest on the bank loan is deductible for income tax purposes. If the personal loan approach of Accounts Receivable Financing is being used, the answer is almost certainly no. This is because personal loan interest is generally non-deductible. If the business loan approach is being used, the answer is maybe.

I.R.C. section 162 permits a deduction for all reasonable and necessary expenses incurred in carrying on any trade or business. Typically, interest on loans taken out for a business purpose would be deductible pursuant to this Code section. However, I.R.C. section 264(a)(2) disallows the deduction of “any amount paid or accrued on indebtedness incurred or continued to purchase or carry a single premium life insurance, endowment, or annuity contract.” A contract is treated as a single premium contract if substantially all the premiums on the contract are paid within a period of 4 years from the date on which the contract is purchased.

Considering that the business does not utilize the bank loan proceeds to purchase a life insurance policy or annuity, nor does the business have an interest in the policy purchased by the business owner, it is questionable whether section 264 would apply to disallow an interest deduction. However, it is possible that since the bank loan proceeds were indirectly used to purchase a life insurance policy and that policy is being used as secondary collateral for the bank loan, this could be determined to be sufficient to invoke section 264. Therefore, it is unclear whether the bank loan interest is deductible to the business in a situation where the business loan approach is being used.

### Tax Consequences of Guaranty

As is discussed in the Personal Loan Approach section of this Guide, one potential issue with that approach concerns the tax ramifications of the business guaranteeing the bank loan personally taken out by the business owner or professional. There does not appear to be any direct guidance on this issue. It is possible that the IRS could take the position that the business’ guaranty of the owner’s loan confers an economic benefit upon the owner that results in current taxation of the value of the guaranty. Alternatively, it could be argued that there is no income realization unless and until the business is called upon to satisfy the loan obligation.

Clearly, if the business were called upon to satisfy the personal loan obligation, that event would have tax consequences to the business owner. To also take the position that the guaranty itself has tax consequences would appear to be taxing the same potential event twice. It would seem that if the guaranty is taxable, then some sort of credit should be available when determining the tax consequences resulting from the business’ actual satisfaction of the loan obligation.

Assuming that the business owner’s tax and legal advisor takes the position that the guaranty may be taxable, the next question is how should the guaranty be valued? Valuing a guaranty for income tax reporting purposes is likely to involve examining the amount charged as a loan guaranty fee in comparable commercial loan transactions. Loan guaranty fees typically range between 1% and 3% of the amount of the loan, with the amount of the guaranty fee, as a percentage of the loan, increasing based upon the amount and duration of the loan.

## Third Party AR Financing Vendor Programs

Although ING does not endorse or promote any specific Accounts Receivable Financing plan, the ING companies will allow the use of its life insurance products with certain plans. The list of vendors that ING will allow its products to be used with is regularly published by ING and can be obtained by contacting your business owner, professional ING representative.

The third party AR Financing vendors provide the primary marketing, sales, training, legal, and administrative support for their plan. In addition, oftentimes they will have a relationship with one or more lenders that are willing to provide the financing for their plan. ING companies do not provide lending in conjunction with the AR Financing concept.

ING does not provide any legal or tax advice and it is always ING's position that an insured should consider using an Accounts Receivable Financing arrangement for the purposes of financing life insurance products only with the guidance of appropriate legal and tax counsel.

## What Next?

For more information about Accounts Receivable Financing, please contact your ING representative or the National Sales Support Team at 866.ING.SELL (464.7355). Here a dedicated team of professionals will provide you with all the assistance you'll need to close your next sale!

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# Have You Protected Your Future?

## You've worked hard to build your business...

- Obtained the financing
- Obtained the qualifications and licenses
- Put in the long hours

Isn't it about time you took some steps to secure your future?

**Your Accounts Receivables may be your single largest business asset. As a balance sheet item, it is exposed to lawsuits and creditors of the business.**

- Are you concerned that your Accounts Receivable balance is exposed to creditors?
- Would you like to help protect your Accounts Receivables while at the same time potentially create more money for retirement?

## Accounts Receivable Financing is a potential solution!

### Benefits of Accounts Receivable Financing:

- Protects your Accounts Receivable from the claims of creditors (other than the lending institution taking the primary lien against the receivables balance)
- Transforms your Accounts Receivable balance into a performing asset
- May provide you with tax-advantaged supplemental retirement income

### Want to Hear More?

For all of your life and business planning needs, call me so I can help you plan for a secure financial future.

**ING. Your future. Made easier.<sup>SM</sup>**

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# Accounts Receivable Financing

You've Worked Hard to Build Your Business

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# Protect Your Future

## With Accounts Receivable Financing

You've worked hard to build your business. You've obtained the financing, education and earned the necessary credentials and qualifications. You've put in the long hours.

Isn't it about time that you took some steps to protect your future?

### **Accounts Receivable Financing**

Your business' single largest asset may be its accounts receivable balance. As a balance sheet item it is exposed to the claims of the business' creditors. In addition, it is subject to claims resulting from the acts of any employee of the business, not just yours!

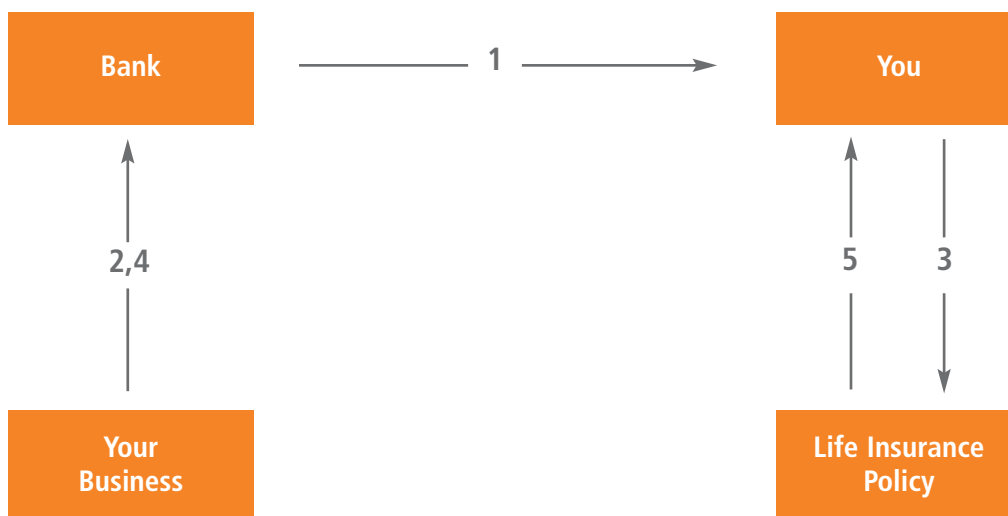
Are you concerned that your accounts receivable balance is subject to the claims of the business' creditors? If, without adversely affecting your ability to conduct day-to-day business, you could use your accounts receivable balance today to provide a tax-advantaged retirement income for the future, would you do so? Accounts receivable financing may be a potential solution!

### **Benefits of Accounts Receivable (AR) Financing**

- Protects your accounts receivable from the claims of creditors (other than the lending institution taking the primary lien against the receivables balance).
- Transforms the accounts receivable balance into a performing asset.
- May provide you with tax-advantaged supplemental retirement income.

## How It Works

(Example illustrating a personal loan approach)\*



1. The bank makes a personal loan directly to you.<sup>1</sup>
2. Your business pledges the accounts receivable balance as the primary collateral for this loan. Since the bank has a primary lien against the accounts receivable balance, this may protect it from the claims of other creditors.
3. You use the loan proceeds to purchase a life insurance policy that you will own. The life insurance policy will be used as secondary collateral for the bank loan.<sup>2</sup>
4. At retirement the loan is repaid primarily using the remaining accounts receivable. Typically, the loan agreement provides that the loan must be repaid within a specified time after retirement, for example, 120 days). This provides time to collect the outstanding accounts receivable.<sup>3</sup>
5. You can now begin to take supplemental retirement distributions from your life insurance policy, if you so choose.

<sup>1</sup> The loan is typically made in year one and is generally equal to the 90 day revolving accounts receivable balance. In addition, the loan is interest only while outstanding and bears a competitive interest rate.

<sup>2</sup> One benefit of purchasing life insurance is that it may enjoy protection under state creditor protection statutes. A second benefit is that the cash value growth is tax-deferred. A third benefit is that if the policy is properly designed to be a non-Modified Endowment Contract (non-MEC), it may be possible to take tax-free distributions from the policy.\*\*

<sup>3</sup> Once the loan is repaid, the bank's secondary collateral interest in your life insurance policy is released.

\* There are different ways to structure an accounts receivable financing arrangement. Two of the primary approaches are the business loan approach (bank loan is made to the business and the loan proceeds in turn are distributed to the business owner) and the personal loan approach (bank loan is made directly to the business owner). For simplicity purposes, this example illustrates only the personal loan approach.

\*\* Distributions (withdrawals or policy loans) from life insurance policies treated as Modified Endowment Contracts ("MECs") under I.R.C. Section 7702A are subject to less favorable tax treatment than distributions from policies that are not MECs. If the policy is a MEC, distributions will be taxable to the extent there is any gain in the policy. In addition, a 10% penalty tax on the taxable amount may also apply. Without regard to whether a policy is a MEC, any gain in the policy is taxable upon full surrender of the policy. Income tax-free distributions are achieved by withdrawing to the cost basis (premiums paid), then using policy loans. Policy loans will reduce the policy's cash value and death benefit. Withdrawals will reduce the policy's cash value and may reduce the death benefit. This assumes the policy qualifies as life insurance and does not lapse. If the policy lapses or is surrendered, the IRS will tax distributions received over the life of the policy and at termination that are in excess of total premiums paid.

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STANDARDS ASSOCIATION





SMART TOOLS FOR CREATING FINANCIAL BLUEPRINTS

## Accounts Receivable Financing

*Leveraging Business Assets for  
Retirement Income*



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Welcome to our “Smart Tools” introduction of Accounts Receivable or “A/R” Financing. This technique fits into the Blueprint Campaign as an “Outside Resource” of life insurance premiums and can be used to help small business owners gain valuable death benefit protection, supplement personal retirement income, and create an additional layer of asset protection for non-performing business assets.

## Disclosures



- Neither ING nor its affiliated companies or its representatives give tax or legal advice. The strategies suggested may not be suitable for everyone, and each individual should consult with his or her own tax advisor and legal counsel before implementing any of the strategies discussed here.
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At the outset, I want to make it clear that the information I'm sharing shouldn't be considered tax or legal advice. My comments are designed to be general. For specific tax or legal advice your client should consult his or her attorney or tax advisor. They can give advice specific to your client's situation and they can provide the best answers to specific tax or legal questions that your client may have.

## Questions for Business Owners and Professionals



- Are you making the most effective use of your business assets?
- Would you like to leverage business assets to create additional resources for retirement or to contribute to a legacy for your family?
- Are you concerned about protecting business assets from creditors?



As business owners and professionals, I want you to consider the following questions:

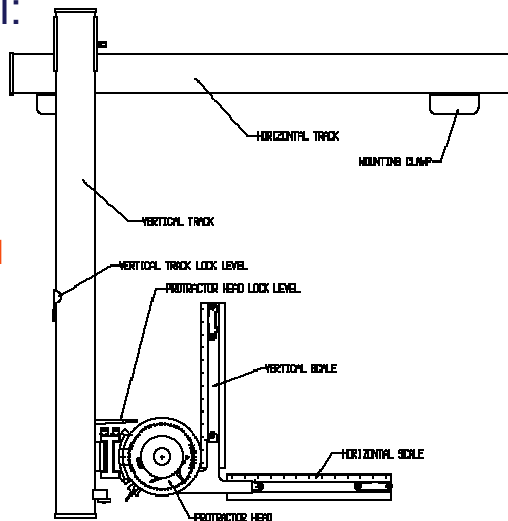
Are you making the most effective use of your business assets?

Would you like to leverage business assets to create additional resources for retirement or to contribute to a legacy for your family?

Are you concerned about protecting business assets from creditors?

## A Leveraging Tool:

- Transform a non-performing asset
- Create Tax-Advantaged retirement income
- Provide Creditor Protection



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Let me introduce you to Accounts Receivable Financing.

Accounts Receivable Financing is a technique for funding life insurance premiums for small businessowners and professionals. A/R financing is essentially premium financing that uses a business owner's accounts receivable as collateral for the loan.

[click]

Accounts receivable is a business book keeping item that represents money that has yet to be paid for services rendered. In simple terms, accounts receivable are all of the i.o.u's for customers that haven't yet paid their bills. These are non-performing assets. A/R financing gives business owners an opportunity to make these i.o.u's productive.

[click]

A business owner can leverage accounts receivable to purchase life insurance and create a potential source of supplemental retirement income.

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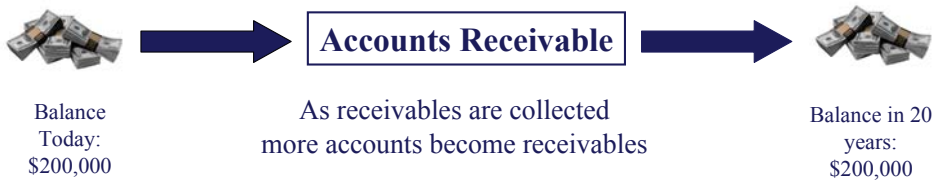
Depending upon state law, purchasing life insurance with a/r financing can also add a layer of creditor protection to your business assets.

## Problems Faced by Business Owners and Professionals



### Non-Performing Assets

- Business Owners typically have a very large non-performing asset—their Accounts Receivable.
- Ideally, most business owners would like to find a way to make this asset productive.



One problem you face as a business owner is whether you are able to make all of your assets work for you.

Remember my first question, “Are you making the most effective use of your business assets?”

I want you to consider one asset in particular, your accounts receivable.

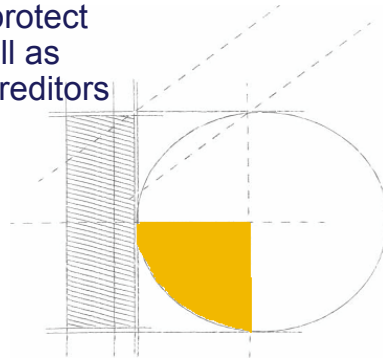
As I just mentioned, this asset is simply a book-keeping item reflecting money you haven't yet received from your customers. As a book-keeping item, it is stagnant--it doesn't produce any return. Would you be interested in leveraging this book-keeping item to purchase an asset that does produce a return?

## Problems Faced by Professionals



### Liability

- Many professionals are concerned that one of their largest assets (their Accounts Receivable) is vulnerable to creditors and lawsuits.
  - Malpractice risk.
- These professionals would generally be interested in finding a way to protect their Accounts Receivable (as well as other assets) from the claims of creditors of their business.



Another problem facing business owners--especially professionals such as doctors and lawyers--is potential liability to creditors. Because of this, business owners are often concerned about whether their business assets--including accounts receivable--can be protected from creditors.

Accounts Receivable Financing is a technique which may be able to address the problems of non-performing assets and creditor protection and which may be able to provide some additional benefits.

## Benefits of AR Financing



### Transforms Non-Performing Asset

- Accounts Receivable Financing enables a non-producing asset to be leveraged in the purchase of a producing asset.
- Supplemental retirement income may be provided by the return on the performing asset.



**Accounts Receivable**



Value of Accounts Receivable is invested and has the opportunity to grow into a larger amount.

First and foremost, Accounts Receivable Financing offers a way for business owners to take advantage of an otherwise non-performing asset. By pledging their accounts receivable as collateral for a loan, business owners can invest the proceeds to provide death benefit protection and/or supplemental retirement income.

## Benefits of AR Financing



### May Create Tax-Advantaged Retirement Income

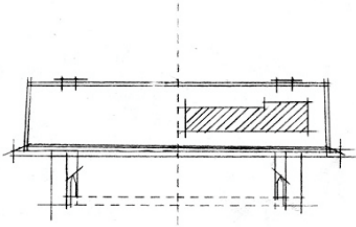
- Potential to acquire loan proceeds with little to no tax consequences.
  - Entire amount of loan can be invested.
- Loan proceeds can be invested in an income tax-deferred vehicle (such as life insurance).
- At retirement, funds can potentially be accessed tax-free from the life insurance policy.\*

\* *Income tax-free distributions are achieved by withdrawing to the cost basis (premiums paid), then using the policy loans. Policy loans will reduce the policy's cash value and death benefit. Withdrawals will reduce the policy's cash value and may reduce the death benefit. This assumes the policy qualifies as life insurance, is not a modified endowment contract, and does not lapse. If the policy lapses or is surrendered, the IRS will tax distributions received over the life of the policy and at termination that are in excess of total premiums paid.*

By investing loan proceeds in a permanent life insurance policy, business owners can provide death benefit protection for their families while also creating an additional source of retirement income that is under their control, allows tax-deferred growth, and permits tax-free distributions (provided the life insurance contract is not a modified endowment contract and they use a combination of withdrawals up to policy basis and taking policy loans thereafter).

### Potential Creditor Protection

- Accounts receivable may be protected from attachment resulting from lawsuits and claims of other creditors due to the fact that the bank has a primary lien against the receivables.\*
- If the loan proceeds are used as premium payments into a life insurance policy, then depending upon state law, the cash value of the policy may be wholly or partially exempt from creditors of the policy owner.\*



*\* Clients should consult their own legal counsel as to extent, if any, to which the accounts receivable and life insurance cash value and death benefit may be protected from creditors.*

Accounts Receivable Financing may also provide some additional protection for business assets (at least for the accounts receivable). While the Accounts Receivable Financing does not provide true creditor protection, pledging the accounts receivable as security for the bank loan has the effect of discouraging other creditors from trying to reach this asset. This discouragement is due to the fact that unsecured creditors will be second in line and can get nothing from the accounts receivable until the bank has been paid in full.

Also, depending on the creditor protection laws for your state, the cash value of life insurance may be wholly or partially exempted from the claims of personal creditors.

## AR Financing – How It Works



### Bank Loan Applied For

- Business or business owner will apply for a loan.
  - An AR Financing program will generally have a pre-existing relationship with at least one bank that is willing to make such a loan at a competitive interest rate.
  - This loan generally is equal to 100% of the 90-day revolving accounts receivable balance.
  - Loan payments are interest only until the owner retires.
  - The primary source of collateral for the loan is the business' accounts receivable.
  - If the business is the loan applicant, the loan proceeds will subsequently be transferred to the business owner. The business' guaranty of the loan may have tax consequences to the business owner.



So how does Accounts Receivable Financing work?

The first step is for the business or business owner to apply for a bank loan. There are a number of Accounts Receivable Financing Programs that will help you obtain such financing.

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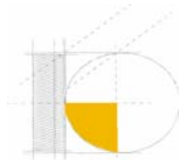
## AR Financing – How It Works



### Bank Loans Proceeds Invested

- Once the business owner has received the bank loan proceeds, the business owner can then choose to invest the proceeds for supplemental retirement purposes.
  - One option is to use the proceeds to pay premiums into a cash value life insurance policy, which grows income tax-deferred.\*

*\* The primary purpose of life insurance is to proceed a death benefit. Therefore, the client must have a basic need for the death benefit coverage. In addition, the business owner will need to meet medical and financial underwriting requirements in order to qualify for the life insurance coverage.*



If the loan is approved, the second step is for the business owner to invest the loan proceeds. Investing in a permanent life insurance contract is an option which can provide death benefit protection and an additional source of retirement income.

## A/R Financing – How it Works



### Bank Loan Proceeds Invested (cont.)

- Assuming the business owner chooses to use the bank loan proceeds to pay premiums for a life insurance policy, the policy could then be used as secondary collateral for the bank loan.
- In order to ensure that the life insurance can provide tax-advantaged retirement income, the policy must be designed as a non-Modified Endowment Contract (non-MEC):
  - To avoid creating a MEC, the bank loan proceeds will generally be put into an immediate annuity or escrow account, and will then be paid into the policy over several years.\*

*\* If an immediate annuity is used, there will be fees and charges associated with it, as well as with the life insurance policy.*



If the business owner chooses to invest in permanent life insurance, the policy may be used as secondary collateral for the loan.

Again, to qualify for tax-advantaged distributions from the policy, it must be designed so that it is not a modified endowment contract (or “MEC”). Generally, this means premiums must be paid over a period of years (rather than all at once) and a minimum level of death benefits must be maintained.

### Loan Repaid at Retirement

- Upon the business owner's retirement, his or her share of the accounts receivable are collected and are used to repay the bank loan.
- Keep in mind that these receivables, once collected, will be income taxable.
- Once the loan is repaid, the bank's interest in the secondary collateral (i.e. the life insurance policy) is released.



Upon reaching retirement, the business owner waits until his or her share of the business' accounts receivable are collected and uses the funds to pay off the bank loan. The bank, in turn, releases its security interest in the life insurance policy, leaving the owner in full control of the policy and its cash value.

## AR Financing – How it Works



### The retirement income stream commenced

- Once the business owner has retired and the bank loan has been repaid, the owner can access his or her life insurance policy cash value for supplemental retirement income purposes.
- Assuming the policy is a non-MEC, the professional can receive a tax-advantaged retirement income.\*

*\* Income tax-free distributions are achieved by withdrawing to the cost basis (premiums paid), then using the policy loans. Policy loans will reduce the policy's cash value and death benefit. Withdrawals will reduce the policy's cash value and may reduce the death benefit. This assumes the policy qualifies as life insurance, is not a Modified Endowment Contract, and does not lapse. If the policy lapses or is surrendered, the IRS will tax distributions received over the life of the policy and at termination that are in excess of total premiums paid.*



Now the business owner can use the policy cash values to provide supplemental income for retirement. Again, distributions from the policy will be tax-free provided the MEC rules are followed and the owner takes policy loans for any distribution amounts that would be over his or her basis.

## A/R Financing in Action Professionals R Us\*



- Specialty practice with three physicians.
- 90-day Accounts Receivable balance of \$600,000.
  - Dr. Watson, 46 years old, AR of \$200,000.
  - Dr. Smith, 41 years old, AR of \$150,000.
  - Dr. Jones, 50 years old, AR of \$250,000.
- All three doctors are making maximum contributions to qualified plans.
- All three doctors have excellent credit.

*\* The hypothetical investment results are for illustrative purposes only and should not be deemed a representation of past or future results. This example does not represent any specific product, nor does it reflect sales charges or other expenses that may be required.*

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Let's look at an example of how the A/R Financing Strategy can be put to use.

Assume a small company, "Professionals R Us," that has three doctor-owners.

[click]

The doctors each have a significant A/R balance.

[click]

All three doctors have already maxed out contributions to qualified plans and [click] all three doctors have good credit.

## Professionals R Us\*



- A bank loan is applied for based upon Dr. Watson's A/R of \$200,000.



*\* The hypothetical investment results are for illustrative purposes only and should not be deemed a representation of past or future results. This example does not represent any specific product, nor does it reflect sales charges or other expenses that may be required.*

Let's look at Dr. Watson.

She would initiate the A/R financing strategy by arranging to borrow \$200,000 from a bank, pledging her \$2000,000 A/R balance as collateral.

## Professionals R Us\*



- A bank loan is applied for based upon Dr. Watson's A/R of \$200,000.
- Dr. Watson now has the ability to use the \$200,000 that was previously only a balance sheet item.

*\* The hypothetical investment results are for illustrative purposes only and should not be deemed a representation of past or future results. This example does not represent any specific product, nor does it reflect sales charges or other expenses that may be required.*

Now Dr. Watson can make this \$200,000 work for her, converting a dormant balance sheet item into a productive asset.

## Professionals R Us\*



- A bank loan is applied for based upon Dr. Watson's A/R of \$200,000.
- Dr. Watson now has the ability to use the \$200,000 that was previously only a balance sheet item.
- She uses the proceeds to pay \$50,000 per year for four years into a **Life Insurance Policy** with a face value of \$875,000.
  - > Policy designed to create income stream at retirement of \$26,000 per year for ten years.

*\* The hypothetical investment results are for illustrative purposes only and should not be deemed a representation of past or future results. This example does not represent any specific product, nor does it reflect sales charges or other expenses that may be required.*

For purposes of illustration, Dr. Watson elects to purchase a life insurance policy with a death benefit of \$875,000. The policy requires annual premium payments of \$50,000 for four years.

Dr. Watson's insurance agent provides her with a policy illustration which provides supplemental income at retirement of \$26,000 per year for ten years based on current crediting assumptions.

## Professionals R Us\*



- A bank loan is applied for based upon Dr. Watson's A/R of \$200,000.
- Dr. Watson now has the ability to use the \$200,000 that was previously only a balance sheet item.
- She uses the proceeds to pay \$50,000 per year for four years into a Life Insurance Policy with a face value of \$875,000.
  - > Policy designed to create income stream at retirement of \$26,000 per year for ten years.
- Although the Loan is primarily secured with Dr. Watson's A/Rs, her life insurance policy may be pledged as **secondary collateral** to the bank.

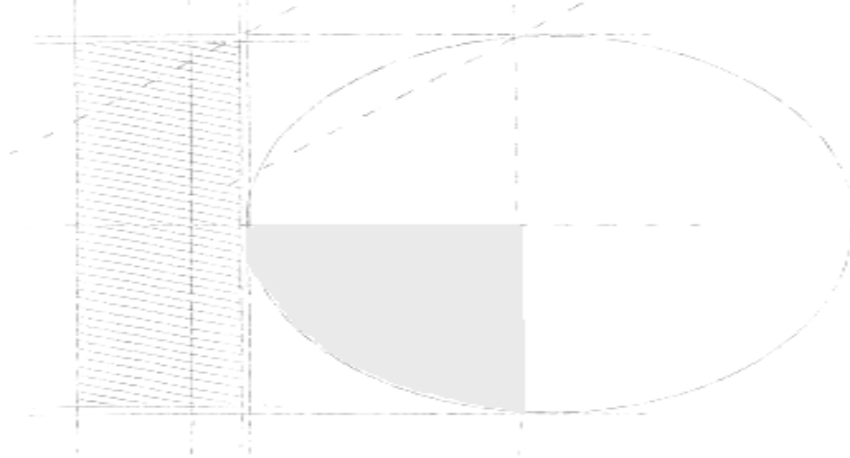
*\* The hypothetical investment results are for illustrative purposes only and should not be deemed a representation of past or future results. This example does not represent any specific product, nor does it reflect sales charges or other expenses that may be required.*

Depending on the lender, Dr. Watson may be required to pledge the life insurance policy as additional collateral for the loan.

## What Have We Accomplished?



If Dr. Watson had done nothing, she would have been able to convert her \$200,000 A/R balance into \$120,000 at retirement (assuming combined federal and state income taxes of 40%). By using A/R Financing, she has:



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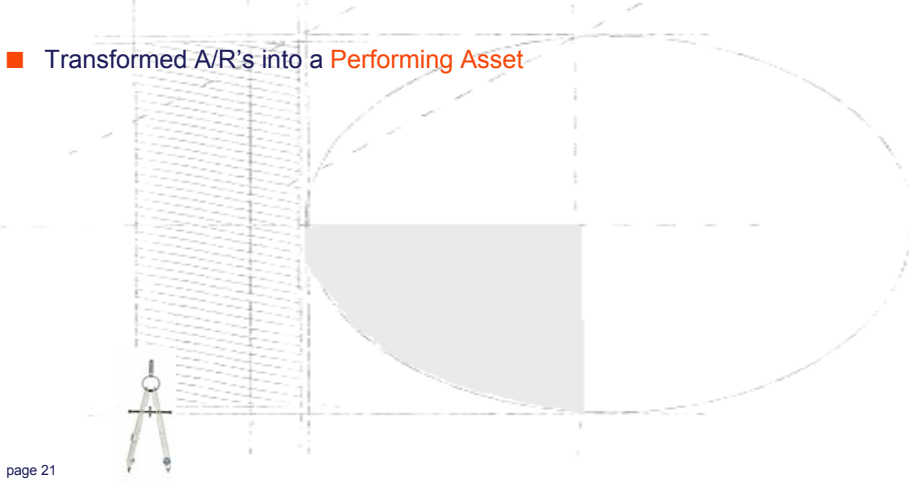
So what has A/R financing accomplished for Dr. Watson? Consider that if she does nothing, the \$200,000 accounts receivable will represent taxable income at retirement. Assuming combined state and federal taxes of 40%, Dr. Watson would receive only \$120,000 for the accounts receivable when she leaves the business.

## What Have We Accomplished?



If Dr. Watson had done nothing, she would have been able to convert her \$200,000 A/R balance into \$120,000 at retirement (assuming combined federal and state income taxes of 40%). By using A/R Financing, she has:

- Transformed A/R's into a **Performing Asset**



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A/r financing has transformed this book-keeping item into a performing asset.

## What Have We Accomplished?



If Dr. Watson had done nothing, she would have been able to convert her \$200,000 A/R balance into \$120,000 at retirement (assuming combined federal and state income taxes of 40%). By using A/R Financing, she has:

- Transformed A/R's into a Performing Asset
- Created **Death Benefit** protection during Dr. Watson's working years.

Dr. Watson has created \$875,000 in death benefit protection for her working years.

## What Have We Accomplished?



If Dr. Watson had done nothing, she would have been able to convert her \$200,000 A/R balance into \$120,000 at retirement (assuming combined federal and state income taxes of 40%). By using A/R Financing, she has:

- Transformed A/R's into a Performing Asset
- Created Death Benefit protection during Dr. Watson's working years.
- Provided a source of **Tax-Advantaged Retirement Income.**



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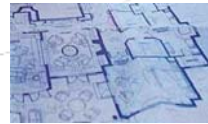
Depending on the policy's actual performance, she has created up to \$260,000 worth of tax-free retirement income.

## What Have We Accomplished?



If Dr. Watson had done nothing, she would have been able to convert her \$200,000 A/R balance into \$120,000 at retirement (assuming combined federal and state income taxes of 40%). By using A/R Financing, she has:

- Transformed A/R's into a Performing Asset
- Created Death Benefit protection during Dr. Watson's working years.
- Provided a source of Tax-Advantaged Retirement Income.
- Erected an additional layer of **Asset Protection** between her business and potential creditors.



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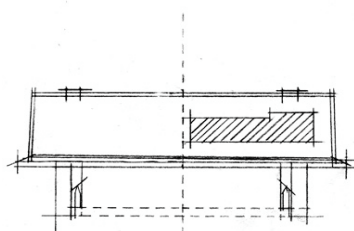
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Finally, depending on the laws of her state, Dr. Watson has created an additional layer of asset protection for part of her business.



Your ING representative can show how this idea might work in your situation.

Ask for a proposal customized to fit your situation.



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I'd like to help you determine if Accounts Receivable Financing might help you get the most out of your business assets. Would you like me to create a customized proposal to meet your needs?