Key employee retention and retirement

Tax diversification can help increase income.

Everyone wants to maximize cash flow—especially in retirement when you want to make sure you can maintain your current lifestyle. One way that can help is by minimizing taxes through tax diversification of your assets.

Bonus plans for you and/or your key employees have funding options with varying tax implications. So, as you consider a plan from Principal®, it's a good idea to look carefully at those options to get a better idea of the potential tax outcomes.

You have options

Let's compare three different funding assets for your bonus plan to another common source of retirement income—a 401(k) plan.

		Bonus plan financing options		
	401(k) plan	**Mutual fund**	**Deferred annuity**	**Life insurance**
At time of contribution				
Income taxable	No	Yes	Yes	Yes
FICA taxes apply	Yes[1]	Yes[2]	Yes[2]	Yes[2]
Growth				
Tax deferred	Yes	No	Yes	Yes
At time of distribution				
Income taxable	Yes	Yes[3]	Yes (LIFO)[4]	No (FIFO)[5]
Capital gain tax applies to growth	No	Yes[3]	No	No
Tax to heirs				
Income taxable	Yes	No	Yes	No

LIFO: Last in, first out. **FIFO**: First in, first out.

The above comparison provides an overview of the possible tax outcomes and is provided for educational and informational purposes only. It is not intended to provide a complete comparison of all asset types nor make life insurance appear to be an alternative to traditional retirement vehicles. Specific situations may vary and should be discussed with your professional tax advisor.

[1] Employer contributions to a qualified plan are excluded from the definition of "wages" under Social Security and are not subject to Social Security taxes.

[2] If business is an S-corporation, FICA applies only if W-2 compensation is used.

[3] Mutual funds pass their dividends, interest, and capital gains to their shareholders. Capital gain or loss may also be recognized upon sale of mutual funds shares. To the extent the funds are invested in tax-exempt bonds, interest may be federal and/or state income tax-free.

[4] Withdrawals may be subject to surrender charges, and are taxable as ordinary income to the extent of the gain in the contract. Withdrawals prior to age 59½ may be subject to a 10% penalty.

[5] Withdrawals are generally tax-free until cost basis has been recovered. Thereafter, policy loans are generally tax-free unless the policy lapses. Withdrawals and loans will reduce the policy cash surrender value and net death benefit and may cause the policy to lapse. Lapse of a life policy may cause loss of death benefit and adverse income tax consequences. A life insurance policy classified as a modified endowment contract (MEC) will have less favorable tax treatment during the life of the insured compared to other life insurance (non-MEC policies). Such tax treatment would be similar to tax treatment of a deferred annuity.

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