

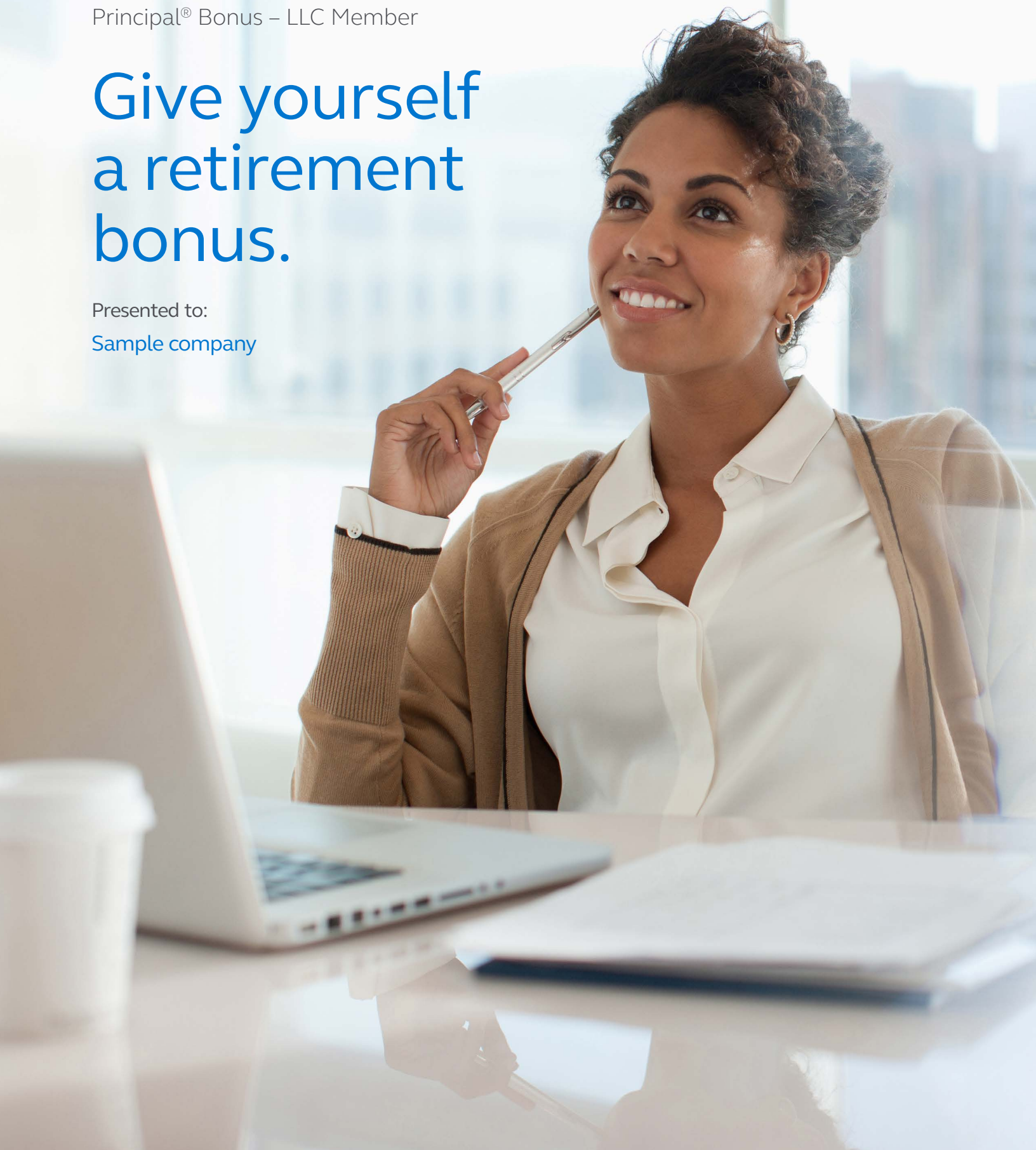


Principal® Bonus – LLC Member

# Give yourself a retirement bonus.

Presented to:

Sample company



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## Proprietary and confidential

We appreciate the opportunity to prepare and present this bonus plan.

The information contained in this proposal has been developed based on our years of knowledge and experience in the key employee benefits industry. Rest assured that the information contained in this proposal will be kept strictly confidential.

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# A retirement benefit that offers tax leverage and flexibility.

As a limited liability company (LLC) member (taxed as a partnership), you've likely experienced some tax advantages. However, this business structure can also present you with challenges when it comes to retirement planning.

**Taxes on profits.** You must pay income tax on profits even if you don't take them in cash.

**Self-employment taxes.** All income, including guaranteed payments and profit, may be subject to self-employment taxes (assuming members are active in the business and they choose to file as a partnership or sole proprietor for federal tax purposes).

**Fringe benefit limitations.** You may be taxed unfavorably or they may be unavailable altogether.

When it comes to your assets and planning for retirement, an LLC member typically has three kinds of assets. Let's take a look at what those are and some potential considerations:

## Qualified retirement plans

### Pre-tax assets

- 401(k) plans
- SIMPLE IRAs
- Defined benefit plans
- Simplified employee pension plans (SEPs)

### Considerations

- Contributions are made on a pre-tax basis and grow tax-deferred.
- Distributions are taxable.
- Restrictions limit contributions to and distribution from these plans.

## Investments

### After-tax assets

- Mutual funds
- Certificates of deposit (CDs)
- Stocks
- Bonds
- Annuities

### Considerations

- These are typically purchased with after-tax dollars.
- Distributions may be subject to capital gains, dividend income, or ordinary income taxes.

## Personal assets

### After-tax assets

- Business ownership
- Home ownership
- Property

### Considerations

- A successful business introduces growth to your wealth and helps provide you with a controlled asset.
- Growth in the company is taxable.

## Multiple benefits in one solution

You've likely become accustomed to a certain standard of living. To maintain that in retirement, consider a bonus plan designed specifically for LLC members. It can offer benefits for you and your family:

**Retirement income.** You can save more for retirement than you might be able to through other means that limit contributions and restrict compensation.

**Tax leverage.** By using life insurance to finance the plan, you can take advantage of tax benefits not available through other savings or financing vehicles.

**Protection.** You gain peace of mind knowing your family will receive a benefit upon your death. You may also use it to fund disability protection.

### WHAT TO EXPECT

Let's walk through the flexibility of this plan and how it can be tailored to fit your specific needs. You're in control of key decisions and determining next steps. So, this proposal will help you do that by covering the following areas:



**Design.** Choose the plan design that can help you accomplish your goals..



**Financing.** Decide which financing option best balances long-term costs and plan benefits.



**Support.** Understand the valuable support services available to maintain this plan.

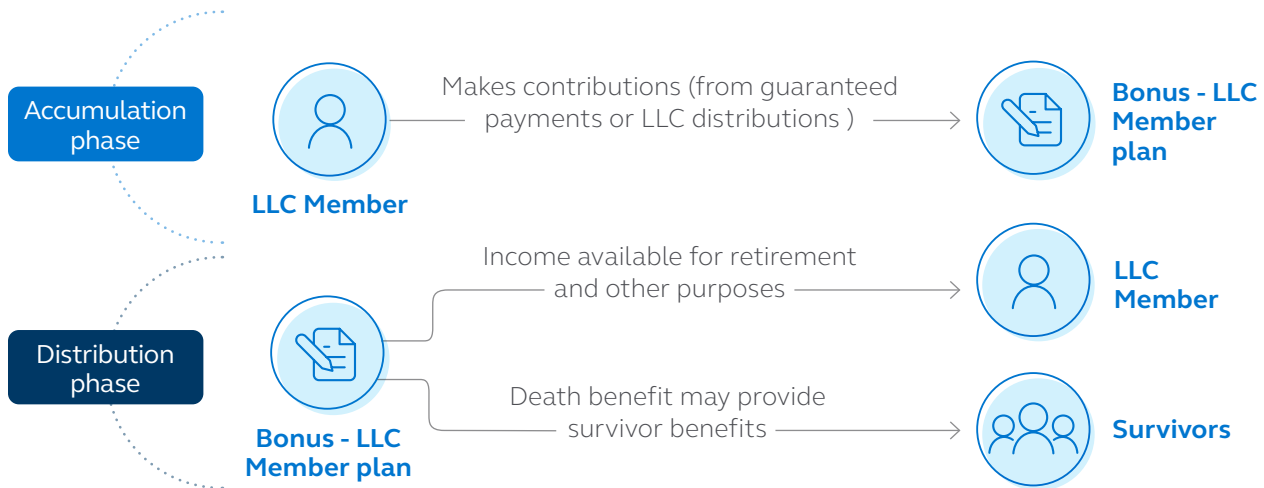


**Next steps.** Review how to implement your plan.

Before we dive into the details of the design elements, let's take a quick look at how the plan works and its benefits and considerations.

## Here's how it works

You select an amount to contribute from your guaranteed payments or share of LLC distributions. Your dollars are used to finance a personally owned asset—like life insurance. At retirement, you may access the values in the financial asset to help supplement your retirement income.



## Benefits and considerations

**Save more.** While qualified plans and Roth IRAs offer tax benefits, they have limits on compensation and contributions that don't apply to this bonus plan.

**Diversify assets.** This allows you to build assets outside your business.

**Choose from contribution options.** Any bonus contributed to this plan can be made from your guaranteed payments or share of distributions.

**Pay out distributions properly.** If there's more than one owner and bonuses are made from distributions, the distributions need to be in accordance with the LLC operating agreement and/or applicable state statutes.

**Pay income tax now.** Whether profits are distributed to LLC members or retained for business expansion, members are taxed at current ordinary income-tax rates.<sup>1</sup>

**Need to be healthy.** You must be able to qualify for life insurance if you choose to use it for financing the plan.

**Choose alternate financing options.** If you or another LLC member is unable to qualify for life insurance, other options for financing the plan are available. These options will have different tax implications regarding accumulation and distribution. And, administrative services may vary.

<sup>1</sup> LLC members (who have chosen to be taxed as a partnership or S corporation) report their share of business profits on their personal tax returns. Depending on your type of business and other personal income, you might be entitled to a deduction of up to 20% of your passthrough income, as a result of a deduction added by the Tax Cuts and Jobs Act.

# Tailor a plan to meet your needs.

You're in control of making this plan yours—it's based on your personal needs as an owner. Together with your financial professional, we'll walk you through the decisions that need to be made to design a plan that makes sense for you. Consider the following as you tailor your plan:

## Who's eligible to participate in the plan?

Any LLC member may participate.

## What amount can you and the other owners contribute?

Each owner selects the amount they want to contribute on an after-tax basis. You can structure your plan contributions in one of three ways:

**Guaranteed payment.** You may receive a guaranteed payment, and you can allocate all of it (or a portion) to the plan. That allocation is subject to income tax and self-employment taxes.

**Profit distribution for active members.** You may receive a profit distribution. If there's more than one member, profits distributed need to be in accordance with the LLC operating agreement and/or applicable state statutes. Profit distributions are taxable for income-tax purposes, as well as self-employment tax.

**Profit distribution for non-active members.** Those members not active in the day-to-day management of the business may receive a share of profit distributions (in accordance with the LLC operating agreement and/or applicable state statutes). They must pay income taxes on this income, but it may be exempt from self-employment taxes.

## What happens with the contributions?

Plan contributions are used to fund a personally owned financial asset. You pay income tax on the contributions going into the plan. However, benefit distributions from the plan may be income tax-free if life insurance is used to finance the plan.<sup>1</sup> This contrasts the taxation of qualified plans, where contributions going into the plan are tax deferred, but the benefit is taxed when paid out. Together, these plans can provide you with a more income tax-diversified and comprehensive retirement program.

## How and when are benefits paid?

There may be some restrictions on access to funds based on the plan's financial asset. But generally, you determine when to take distributions.

<sup>1</sup> 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.

### **What are the tax implications of this plan?**

A lot depends on the funding vehicle that you choose, but benefits and considerations may include:

- The opportunity for tax diversification planning.
- Building assets outside your business, which provides potential tax-deferred growth.
- Potential favorable taxation at distribution.
- Possible annual taxation of earnings inside the plan.
- Avoiding mandatory distributions at age 72.
- Possibly avoiding penalties for distributions before age 59½.

### **Are there other things to consider with this plan?**

- Can provide enhanced retirement benefits and may provide survivor benefits.
- Offers an opportunity to reduce your exposure to business creditors and diversify your investment and tax portfolios.
- Provides exemption from certain annual reporting requirements.
- Gives you maximum control, because you select and own the asset.
- Financing asset may be subject to the owner's general creditors (depending on the financial asset selected and applicable state laws).



# Financing your plan

A financing asset is needed, so plan contributions may accumulate for future distributions. What can you use? Well, you have some options. The one that’s best for you depends on your age, health, needs, and objectives, as well as the degree of risk that’s acceptable to you.

- **Taxable asset.** Contributions are invested in vehicles, such as stocks, bonds, CDs, or mutual funds.
- **Life insurance.** Contributions are paid into a life insurance policy—fixed, indexed, or variable.

	Taxable asset	Life insurance
Benefits	<ul style="list-style-type: none"><li>• Many investment options</li><li>• Direct crediting of earnings</li><li>• Flexible contributions</li><li>• No medical underwriting</li><li>• Long-term gains taxed at capital gains rates</li></ul>	<ul style="list-style-type: none"><li>• Earnings accumulate tax deferred</li><li>• Tax-advantaged distributions, such as loans and partial surrenders (subject to policy limitations/charges)<sup>1</sup></li><li>• Tax-free life insurance death proceeds may bypass probate process and protect dependents</li></ul>
Considerations	<ul style="list-style-type: none"><li>• Earnings taxable to key employee annually</li><li>• No death benefit</li><li>• Distributions in excess of basis are taxable</li><li>• Fees and expenses</li></ul>	<ul style="list-style-type: none"><li>• Owner must be insurable</li><li>• Medical underwriting</li><li>• Impact of loans and withdrawals<sup>2</sup></li><li>• Cost of insurance, policy fees and expenses</li></ul>

To help you better weigh your options, review the detailed financial model included with this proposal.

Investing in mutual funds or variable life insurance involves risk, including the potential for loss of principal.  
Product guarantees are based on the claims-paying ability of the issuing insurance organization.

<sup>1</sup> 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.



# Tax diversification can help maximize income.

As you review your overall retirement plan, you may realize that a lot of your other retirement income will be taxable. This bonus plan for LLC members offers options with varying tax implications. It allows for tax leverage similar to a Roth IRA without restrictions on eligible income or contribution limits.<sup>1</sup> The tax leverage is found in the life insurance product used to finance the plan, rather than being based on a plan-level tax code provision.

Let's compare two different funding assets for your bonus plan to another likely source of retirement income—a 401(k) plan:

	401(k) plan	Bonus plan financing options	
		Mutual fund	Life insurance
<b>Income taxable at time of contribution</b>	No	Yes	Yes
<b>FICA taxes apply at time of contribution</b>	Yes <sup>1</sup>	Yes <sup>2</sup>	Yes <sup>2</sup>
<b>Tax deferred growth</b>	Yes	No	Yes
<b>Income taxable at time of distribution</b>	Yes	Yes <sup>3</sup>	No (FIFO) <sup>4</sup>
<b>Capital gains apply at time of distribution</b>	No	Yes <sup>3</sup>	No
<b>Income taxable to heirs</b>	Yes	No	No

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's not intended to provide a complete comparison of all asset types. All features of a product should be reviewed when selecting a product. Specific situations may vary and should be discussed with your professional tax advisor.

<sup>1</sup> Employer contributions to a qualified plan are excluded from the definition of "wages" under Social Security and are not subject to Social Security taxes.

<sup>2</sup> If a non-active LLC member uses his or her share of distributions (according to the LLC operating agreement and/or applicable state statutes), self-employment taxes may not apply.

<sup>3</sup> Mutual funds pass their dividends, interest, and capital gains to their shareholders. Capital gains 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.

<sup>4</sup> 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.

# Focused on your plan's details— today and tomorrow

It takes a lot of work to run your business. We understand that you may not have time to think about the details associated with administering a benefit plan like this one. That's why we're here. We have the expertise and services to help you with implementation today and administration throughout the life of your plan.

Our Business Market Administration team at Principal provides dedicated, ongoing support for your employer-owned and employer-sponsored plans funded with life insurance. And as your needs change, or regulations change, we'll help you keep up with both.

## Supporting you every step of the way

Beginning at plan implementation, we understand what you need and what needs to be done. You'll benefit from the complimentary administrative services offered by Principal.

### **Dedicated administrator.**

Personally assists you with enrollments, policy adjustments, service requests, policy illustrations, and more.

### **Plan-level reporting.**

Consolidated reports show current coverage amounts, policy values, and premium information for all owner-participants with life policies under your plan.

**List billing.** Delivers consolidated payment reminders covering all policies under your plan – billed annually, semi-annually, quarterly, or monthly.

**Online access.** Allows you to view policy information at [principal.com](http://principal.com). You can view consolidated plan-level information. Policy owners may also make changes or initiate service requests.



# Walking you through a successful implementation

Helping you tailor a plan to your specific needs and goals is a top priority. Once you're comfortable with the plan design and the financing to support it, attention will shift to you and your financial professional putting the plan in place using the Principal platform.

As everyone works together to successfully implement your plan within your desired timing, our goal is to deliver a positive experience for everyone involved. Here's what you can expect:

## Next steps

### 1 Strategy development

- Finalize plan design
- Confirm funding levels

### 2 Application process

- Educate owners on the funding program
- Collect applications and signatures, if applicable

### 3 Administrative set-up

- Finalize underwriting, if applicable
- Enter plan information into recordkeeping systems

### 4 Implementation

- Begin premium payments
- Issue new insurance policies, if applicable

# You benefit from a company that knows business.

As a business decision maker, your financial needs are different than those of other individuals. So, it only makes sense to work with a company that understands the financial needs of businesses and their owners. We help business owners like you every day. Leverage our expertise, solutions, and services as we consult with you on financial solutions that help address specific needs.

- A member of the FORTUNE 500®, we have \$714 billion in total assets under management and serve clients worldwide of all income and portfolio sizes.<sup>1</sup>
- Year after year, we receive strong financial ratings from the four major rating agencies — A.M. Best Company, Moody's Investor Services, Standard & Poor's, and Fitch Ratings.<sup>1</sup>
- No. 1 small-case business life insurance provider.<sup>1</sup>
- No. 1 provider of nonqualified deferred compensation plans.<sup>1</sup>
- Preparer of thousands of informal business valuations since 2011.
- Reviewer of more than 1,800 buy-sell agreements since 2011.

<sup>1</sup> Principal® 2022 Company Profile, December 2021 <https://secure02.principal.com/publicvsupply/GetFile?fm=DD730&ty=VOP&EXT=VOP>.



# Accounting

As an LLC member, you're interested in the accounting effects of financial transactions as they impact both your company and your basis in the LLC. With this bonus plan, the accounting will vary depending on whether you use the guaranteed payment or the profit distribution design. However, the net effect on the basis of your ownership interest in the LLC is basically the same whichever model you use. The financial asset is owned by you, and not by your company. As such, it's not an asset of the company and does not appear on the company's balance sheet.

Here's an example of how the accounting varies between the two designs. It assumes an LLC member has an initial basis and is considering how to treat some current profit generated by the business.

	Guaranteed payment design	Profit distribution (K-1) design (active and non-active members)
Beginning member basis	\$200,000	\$200,000
Profit available	\$20,000	\$20,000
Guaranteed payment	\$20,000	\$0
Adjusted basis after profit	\$200,000	\$220,000
Profit distribution paid	\$0	\$20,000
Decrease in basis from profit distribution	\$0	\$20,000
Ending member basis	\$200,000	\$200,000

Note: This model does not reflect the deduction that may be available under the Tax Cuts and Jobs Act.



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**Before investing, carefully consider the investment option objectives, risks, charges and expenses. Contact a financial professional or visit [principal.com](https://principal.com) for a prospectus or, if available, a summary prospectus containing this and other information. Please read it carefully before investing.**

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