



Planning report | Business solutions

# Strategies for your family business

Presented to:  
Husband and Wife

Presented by:  
Producer Name



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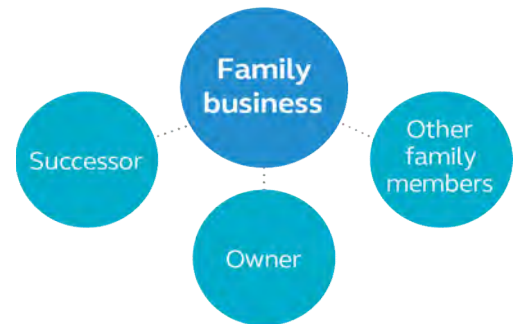
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# Your business

You've spent a lifetime building your business. Now it's time to change gears. Thankfully, you have options. And we'll help you through some simple steps to create a strategy that can provide greater peace of mind.

The most challenging part of exiting your family business is balancing the competing needs of your family members:

- Provide sufficient retirement income for exiting owner
- Leave a healthy business to support itself and your successor
- Assure other family members of an equitable inheritance



Your personalized family business planning report from Principal<sup>®</sup> uses information you provided to develop a starting point. It'll help you begin creating a plan for your financial future, and for the next generation's ownership. From here, we'll work with you and your tax and legal advisors to develop solutions that work best for you. We understand about competing needs in family business planning strategies. This report can help you sort it all out.

## Reviewing this personalized report is an important next step.

Based on the information you've provided, we'll look at three planning categories designed to help you and your family work together to realize your long-term planning goals:

**Buy-sell and succession strategies**

- Buy-sell plan and funding
- Succession plan and funding
- Key person protection
- Key person retention

**Retirement income**

- Retirement analysis
- Supplemental income
- Chronic illness protection

**Legacy and estate planning**

- Wills & trusts
- Inheritance equalization
- Estate taxes
- Gifting techniques

# Your profile



## You

Name	Date of birth	Occupation	Number of remaining working years	Notes
Husband	01/01/1960		5	
Wife	01/01/1962		7	

## Your children

Name	Date of birth	Spouse	Number of children	Notes
Child #1	01/01/1984		3	
Child #2	01/01/1986		0	
Child #3	01/01/1988		2	
Child #4	01/01/1990		0	

## Your parents

Name	Date of birth	Living?	Number of children	Do they have an estate plan?
Father	01/01/1930	No		NA
Mother	01/01/1936	Yes	3	Yes
Father-in-Law	01/01/1930	No		NA
Mother-in-Law	01/01/1936	No	1	NA

## Summary information

Business name	Successor(s)	Entity type	Description
ABC Company	Child #1 and #4	LLC	Construction



# Your goals

## Plan for your transition with a succession strategy

If you're like most family business owners, you haven't given much thought to how, when, and to whom you'll transfer your business. Too often, everyday business can get in the way of long-term planning. But someday, you'll leave your business, whether by a planned or unplanned event.

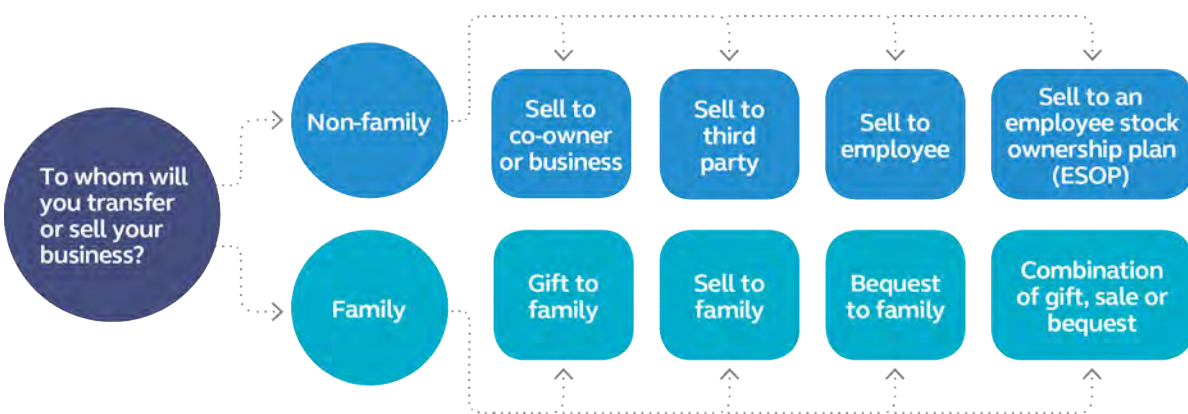
It's important to make plans to exit your business on your terms - no matter what the circumstances are. Proper planning can help protect you and your family under many contingencies including retirement, death, disability, personal bankruptcy, or even a divorce.

## Key items to consider

**Who** – To whom will you sell or transfer the business?

**Timing** – When do you want to transition out of the business?

**Funding** – What will it take to generate the income you need for estate liquidity, succession strategies, and replacement income after your working years?



## Your goals (continued)



### **Who**

You identified your family as the likely successor to your family business. As you are preparing for your business succession, it is equally important that your identified successor also prepares. Coordinating resources helps ensure a smoother, more efficient, and time-controlled transfer. Consider sharing this report with your successor in order to communicate the potential succession plan.

### **Timing**

You indicated that your plan is to transition the family business ownership during your lifetime. Ensure this goal can be accomplished. Coordinate your legal documents with funding sources to make sure sufficient funds are available before planned and unplanned events occur.

### **Asset distribution**

Your goal is to treat heirs as fairly as possible. This means that the inheritances might not be exactly equal. This goal may require additional funding strategies. Review the Inheritance Equalization page to compare potential asset distribution and funding scenarios.

### **Retirement income**

You are unsure if you have adequate income-producing assets and savings to generate enough income for your retirement needs. Review the Retirement Analysis page to further consider this issue.

### **Legacy and estate planning**

You are unsure if you will have to pay federal estate taxes. Review the Estate Tax Protection and Gifting pages to determine your potential federal estate tax liability and examine common techniques to reduce that liability.

# Financial summary



Following is a summary of your financial position based on the information you provided:

Real estate	Owner	Value	Liabilities
Residence	Joint	\$750,000	\$0
Business building	Joint	\$2,000,000	\$0
Vacation home	Joint	\$500,000	\$0
<b>Subtotals</b>		<b>\$3,250,000</b>	<b>\$0</b>

Business	Owner	Value	Liabilities
ABC Company, LLC	Joint	\$8,000,000	\$0
<b>Subtotals</b>		<b>\$8,000,000</b>	<b>\$0</b>

Other assets	Owner	Value	Liabilities
Personal property	Joint	\$100,000	\$0
Vehicles	Joint	\$0	\$0
Collectibles	Joint	\$0	\$0
Future inheritances	Joint	\$0	\$0
Other	Joint	\$0	\$0
<b>Subtotals</b>		<b>\$100,000</b>	<b>\$0</b>

This data is provided for informational purposes and is based on information you provided which may include assets that are not held by any member company of the Principal Financial Group®. Any assets not held by Principal Securities, Inc. may not be covered by SIPC. Refer to the financial statements you receive from your financial services provider(s) for information regarding SIPC membership.

# Financial summary (continued)

Personal assets	Owner	Value	Annual contributions
Cash & equivalents	Joint	\$250,000	\$0
Investments	Joint	\$500,000	\$0
Annuities - you	Husband	\$0	\$0
Annuities - spouse	Wife	\$0	\$0
Retirement plans - you	Husband	\$200,000	\$0
Retirement plans - spouse	Wife	\$200,000	\$0
IRAs - you	Husband	\$0	\$0
IRAs - spouse	Wife	\$0	\$0
Roth IRAs - you	Husband	\$0	\$0
Roth IRAs - spouse	Wife	\$0	\$0
Other			
	<b>Subtotals</b>	<b>\$1,150,000</b>	<b>\$0</b>
	<b>Total</b>	<b>\$12,500,000</b>	

Income sources	Annual income	Age income begins	Age income ends
Wages (W-2, guaranteed payments) - you	\$100,000	59	64
Wages - spouse	\$100,000	57	64
Social Security - you	\$30,000	67	90
Social Security - spouse	\$30,000	67	90
Rental income	\$0	59	90
Business income (K-1, dividends)	\$400,000	59	64
Investment income	\$0	59	90
Pension income - you	\$0	65	90
Pension income - spouse	\$0	65	90
Deferred comp income - you	\$0	59	90
Deferred comp income - spouse	\$0	59	90
Other income	\$0	59	90

Life insurance	Insured	Face amount	Owner	Beneficiary
Principal Term	Husband	\$1,000,000	Husband	Wife

Disability insurance	Insured	Benefit amount	Group or individual	Elimination period
Principal Disability	Husband	\$1,500 per month	Group	180 Days



# Informal business valuation



## Valuing a business

It's important to know the current value of your business so you know how much it can contribute to your retirement income goal. There are different methods for determining value and no one method is always appropriate. Ultimately, the "fair market value" of a business is the amount agreed upon by a willing buyer and a willing seller. Neither party is under any compulsion to buy or sell, and both must have reasonable knowledge of all the relevant facts.

Here are some considerations when valuing a business<sup>1</sup>:

- Nature and history of business
- Outlook for the economy and the specific industry
- Financial condition of the business and its book value
- Earnings capacity of the company
- Nature and value of any intangible assets of the business, such as goodwill
- Relative size and block of the business interest to be valued and any prior sales
- Market price of actively traded stock of corporations in the same or similar business

<sup>1</sup> Per IRS Revenue Ruling 59-60

## The informal valuation of your business

According to the information you submitted, your business is estimated to have a value of \$8,000,000.

We offer a complimentary informal business valuation for many businesses, using five generally accepted methods of valuation. If you would like to consider requesting a complimentary informal business valuation on your business, your financial professional can help you get the process started.

Owner	Ownership %	Value today
• Dad	50%	\$4,000,000
• Mom	50%	\$4,000,000

<b>Totals</b>	<b>100%</b>	<b>\$8,000,000</b>
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### Comments and considerations

- Understand the value of your business and how this relates to your business succession goals.
- Explore whether a complimentary informal business valuation from Principal is appropriate for you.



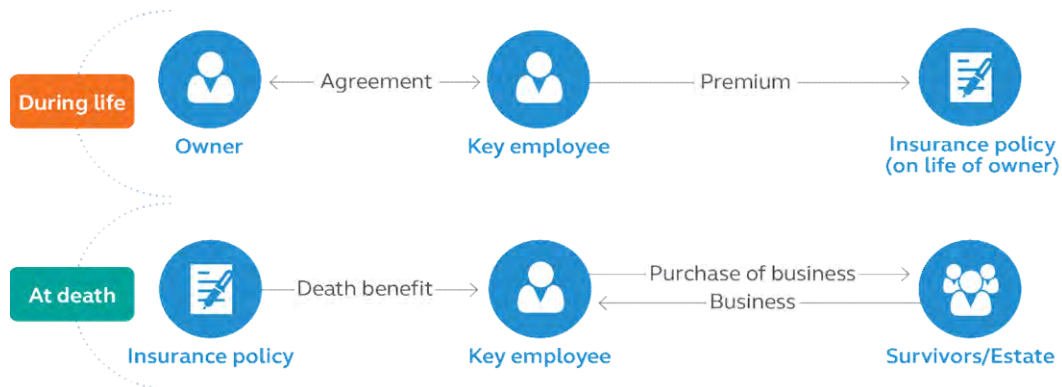
# Buy-sell and succession strategies

## Buy-sell arrangements

Do you have a strategy in place to transfer your business to the right people, at the right time, for the right amount of money? Transitions are more successful when you have established a plan for your departure – whether expected or unexpected. One way you can protect your business is by putting a buy-sell agreement in place. A one-way buy-sell agreement arranges for a potential buyer, ideally a key employee, to purchase your business interest. The purchase can be triggered by your death, disability, retirement or other departure.

### How a one-way buy-sell works

Once the agreement is in place, the key employee (buyer) purchases a life and/or disability insurance policy on you for the agreed upon business purchase price. He or she is then the owner, premium payer and beneficiary of the policy, and uses the proceeds to purchase the business from you or your estate after the triggering event. Proceeds from the sale can then be used by you or your estate to help pay off any outstanding liabilities.



### What you need to know

There are advantages to this sort of an agreement, just as there are some things to consider.

**You're properly compensated** – Selecting a buyer, implementing the agreement and properly funding it helps assure you're compensated for the value of the business you created.

**Business may pay premiums** – Dollars used to pay premiums are taxable as a bonus to the policy owner and are generally deductible by the business.

**Business can avoid disruption** – Having a plan in place, can help retain faithful, long-term employees.

**Key employee can be protected** – A "right of first refusal" provision in the agreement provides some security to the key employee that the business won't be sold to a third party with no recourse.

**Key employee can be required to maintain the policy** – This may mean paying the premiums and notifying you before any policy rights are exercised.

**Disability buy-out insurance is available** – Principal<sup>®</sup> offers unique coverage for this purpose.

### Comments and considerations

- Consider establishing a buy-sell agreement with your successor.
- Discuss with local counsel whether a one-way buy-sell is best suited for your needs.
- Please see the buy-sell funding page to examine funding options.



# Buy-sell and succession strategies

## Buy-sell funding

### Need for funding

Buy-sell agreements involve the selling and buying of a departing owner's interest according to the terms of that agreement. This means money will be needed to complete the transaction when it occurs. So, it's best to have a plan for securing that money. There are basically five options for this.

### Funding options

**Cash** - Requires sufficient cash flow to pay the full price in a lump sum.

**Loan** - Involves unknown factors such as future credit availability and cost of borrowing. Funds borrowed must be repaid (with interest) from earnings. A down payment is generally required.

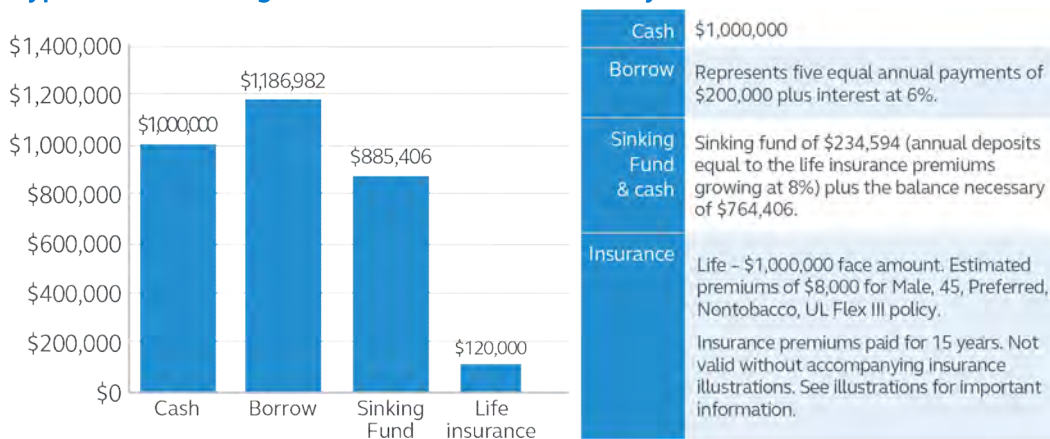
**Savings** - Doesn't assure sufficient funds will be available when needed because the timing of departure isn't predictable.

**Installment sale** - Requires repayment from earnings and is contingent on future success of the business in order to make payments.

**Insurance** - Provides liquidity when purchased upon the implementation of an agreement. Since the death or disability of an owner is often unpredictable and disruptive to a business, each is typically a mandatory triggering event in a buy-sell agreement.

How do you decide which is right for your situation? Timing of liquidity and cost are typically the key considerations. Compare these hypothetical protection costs for a \$1,000,000 purchase price.

### Hypothetical funding method cost at end of the 15 years



### Comments and considerations

- If the business had to transfer tomorrow, would cash flow needed for daily activities be impacted?
- Consider fully funding the buy-sell with life and disability insurance.
- Consult your financial professional about what type of insurance will best meet your needs.



# Buy-sell and succession strategies

## Business succession planning

If you're like many business owners, you're planning on your business playing a role in providing a portion of your retirement income. Succession strategies provide a means to transfer ownership of the business and help you meet retirement income goals. To protect yourself, your family, and your business, it's important to determine how you want to transition your business.

### Common methods for transferring the business

**Lump sum payment.** The buyer purchases the business with a single payment. Oftentimes, the buyer finances part of the purchase price through a third-party lender.

**Installment sale.** The buyer makes a down payment to purchase the business and the balance of the purchase price is paid to the seller on a predetermined payment schedule of principal and interest.

**Interest only sale.** The buyer makes an initial down payment and then pays the seller interest for specified period of time. At the end of the period, the buyer makes a balloon payment to the seller, typically using a third-party loan.

**Part gift, part sale.** With business transactions between family members, the owner typically isn't looking to maximize the sales price of a business interest to a family member. On the other hand, the owner might not want to give the entire business away either. With a part gift, part sale structure, the owner can choose to receive less than the full value of the business from family members, while treating the rest of the transfer as a gift. For those concerned about federal estate tax, discounting might also be available to lower the gift tax value (see the Understanding entity discounts page for more information).

**Employee Stock Ownership Plan (ESOP).** This strategy enables an owner to establish an employee-owned company that offers a flexible, tax-favorable way to exit the business, provide retirement benefits and retain and motivate employees.

### What you need to know

**Payment terms.** Terms can be tailored to match the exiting owner's business and financial needs.

**Financial risk.** If a seller accepts an installment note or interest-only note, there's risk that the buyer will default on the loan.

**Purchase price.** Typically, after tax-dollars are used to fund the purchase price.

**Down payment.** If the buyer is an employee and needs help saving for a down payment, a nonqualified plan may help with funding.

**Supplement retirement income.** Business owners may be able to supplement their retirement income with qualified and nonqualified plans, rental income, consulting agreements, and other arrangements.

**Continued payments.** Payment may be required, even if the seller dies.

**Insurance.** Helps ensure funds are available to make required payments.

**Multiple approaches.** It's not uncommon for business owners to use a combination of approaches.



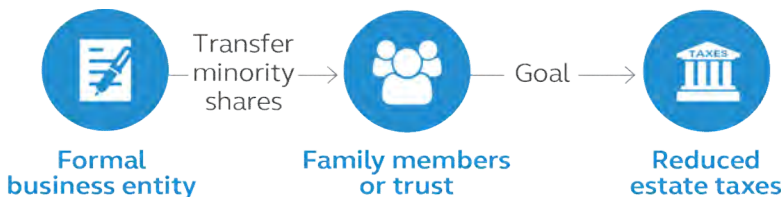
# Buy-sell and succession strategies

## Understanding entity discounts

Business owners are often looking for a solution to reduce their taxable estate while still maintaining control of their assets. The most common solutions involve gifting or otherwise transferring ownership of the assets in question. This can also reduce the owners' federal estate tax liability. Another common way to achieve the same goal is by employing an entity discounting strategy.

### How it works

Owners first transfer real estate or other business assets into a formal business entity, such as an LLC or family limited partnership. Then, they gift a portion of that business entity (shares, membership units) to family members. The "discounting" technique can also be achieved by recapitalizing the business into voting and non-voting interests, with the non-voting interests gifted to family. By keeping the voting interests, the original owners are able to maintain control of the company.



The following hypothetical example shows how entity discounting may reduce an estate tax liability.

		No entity discounting		With entity discounting
Business value		\$8,000,000		\$8,000,000
Hypothetical entity discount	x	0%	x	30%
Less discount	-	\$0	-	-\$2,400,000
Post-discount value	=	\$8,000,000	=	\$5,600,000
Less estate tax exemption	-	\$23,400,000	-	\$23,400,000
Taxable portion	=	\$0	=	\$0
Federal estate tax rate	x	40%	x	40%
Estate tax liability	=	\$0	=	\$0
<b>Hypothetical difference</b>		<b>\$0</b>		

For illustrative purposes only. This hypothetical example is not intended to predict specific values and is used to help explain how discounting works.

### Comments and considerations

- You indicated you would like to transition the business to the family using minority interests and entity discounts.
- Taking advantage of entity discounts may help you achieve these goals.
- Please consult with your tax and legal advisors about appraising the value of any gifts and determining the appropriate discounts (if any).



# Buy-sell and succession strategies

## Lump sum payment model

When a seller doesn't want to accept the risk of an installment sale, the seller may require the purchase price be paid up front. If the buyer doesn't have the funds, they may finance the purchase price from a third-party lender. Oftentimes, sellers will require a lump sum payment for a portion of the purchase price and accept an installment note for amounts the buyer isn't able to finance through traditional lenders.

### How it works

The buyer makes a lump sum payment to the seller. Then the seller transfers the business interest to the buyer. The buyer may finance part of the purchase price through a third-party lender. Life insurance is often purchased to insure the buyer to protect the parties in the event of an untimely death.

Year	Installment note			Cost to buyer		Net to seller			
	Beginning-of-year note value	Interest & principal payment	End-of-year note value	Pre-tax cost	After-tax cost	Annual proceeds	Personal income taxes	Capital gains taxes	Net proceeds to seller
0	0	0	0	2,240,000	3,446,154	2,240,000	0	368,000	1,872,000
1	0	0	0	0	0	0	0	0	0
2	0	0	0	0	0	0	0	0	0
3	0	0	0	0	0	0	0	0	0
4	0	0	0	0	0	0	0	0	0
5	0	0	0	0	0	0	0	0	0
6	0	0	0	0	0	0	0	0	0
7	0	0	0	0	0	0	0	0	0
8	0	0	0	0	0	0	0	0	0
9	0	0	0	0	0	0	0	0	0
10	0	0	0	0	0	0	0	0	0

### Assumptions

Business value	\$8,000,000	Seller's income tax rate	35%
Ownership interest to be sold	40%	Seller's capital gains rate	20%
Value of ownership interest	\$3,200,000	Seller's basis	\$1,000,000
Less minority discounts	30%	Buyer's income tax rate	35%
Sales price	\$2,240,000		

\* Work with your tax advisor to ensure note interest rates are consistent with current requirements.

### Comments and considerations

- Consider the after-tax cost of buying the business in a lump sum.
- Consider whether the buyer has sufficient funds and/or access to lenders to pay the full purchase price.





# Buy-sell and succession strategies

## Installment sale model

Oftentimes, family members or key employees don't have the resources to purchase the business outright. An installment sale can help facilitate the transaction, provide long-term income, and spread the capital gains tax burden over time.

### How it works

The buyer makes a down payment, then using an installment note, the buyer pays the remaining amount based on a predetermined payment schedule of principal and interest. Life insurance is often purchased to insure both the buyer and seller, protecting the sale in the event of an untimely death.

Year	Installment note			Cost to buyer		Net to seller			
	Beginning-of-year note value	Interest & principal payment	End-of-year note value	Pre-tax cost	After-tax cost	Annual proceeds	Personal income taxes	Capital gains taxes	Net proceeds to seller
0	0	0	0	224,000	344,615	224,000	0	36,800	187,200
1	2,016,000	261,081	1,855,719	261,081	401,663	261,081	35,280	26,332	199,469
2	1,855,719	261,081	1,687,423	261,081	401,663	261,081	32,475	27,649	200,958
3	1,687,423	261,081	1,510,713	261,081	401,663	261,081	29,530	29,031	202,520
4	1,510,713	261,081	1,325,168	261,081	401,663	261,081	26,437	30,482	204,161
5	1,325,168	261,081	1,130,345	261,081	401,663	261,081	23,190	32,007	205,884
6	1,130,345	261,081	925,781	261,081	401,663	261,081	19,781	33,607	207,693
7	925,781	261,081	710,989	261,081	401,663	261,081	16,201	35,287	209,593
8	710,989	261,081	485,457	261,081	401,663	261,081	12,442	37,052	211,587
9	485,457	261,081	248,649	261,081	401,663	261,081	8,496	38,904	213,681
10	248,649	261,081	0	261,081	401,663	261,081	4,351	40,849	215,880

### Assumptions

Business value	\$8,000,000	Note term (years)	10
Ownership interest to be sold	40%	Note interest rate	5%
Value of ownership interest	\$3,200,000	Seller's income tax rate	35%
Less minority discounts	30%	Seller's capital gains rate	20%
Sales price	\$2,240,000	Seller's basis	\$1,000,000
Down payment	\$224,000	Buyer's income tax rate	35%
Note value	\$2,016,000		

\* Work with your tax advisor to ensure note interest rates are consistent with current requirements.

### Comments and considerations

- Consider the after-tax cost of buying the business on an installment basis if transferring the business to a family member.
- Consider protecting the sale with life insurance.



# Buy-sell and succession strategies

## Interest only sale model

An interest only sale is similar to a traditional amortized sale. However, interest only payments are made for a period of time with an ending balloon payment of principal. The parties may agree to extend the interest-only payments period but would need to use at least the current Applicable Federal Rate at the time the agreement is modified.

### How it works

The buyer makes a down payment, then using an interest only note, pays the the seller interest for a specified period of time. At the end of the period, the buyer makes a balloon payment to the seller. Life insurance is often purchased to insure both the buyer and seller to protect the sale in the event of an untimely death.

Year	Installment note			Cost to buyer		Net to seller			
	Beginning-of-year note value	Interest & principal payment	End-of-year note value	Pre-tax cost	After-tax cost	Annual proceeds	Personal income taxes	Capital gains taxes	Net proceeds to seller
0	0	0	0	224,000	344,615	224,000	0	36,800	187,200
1	2,016,000	100,800	2,016,000	100,800	155,077	100,800	35,280	0	65,520
2	2,016,000	100,800	2,016,000	100,800	155,077	100,800	35,280	0	65,520
3	2,016,000	100,800	2,016,000	100,800	155,077	100,800	35,280	0	65,520
4	2,016,000	100,800	2,016,000	100,800	155,077	100,800	35,280	0	65,520
5	2,016,000	100,800	2,016,000	100,800	155,077	100,800	35,280	0	65,520
6	2,016,000	100,800	2,016,000	100,800	155,077	100,800	35,280	0	65,520
7	2,016,000	100,800	2,016,000	100,800	155,077	100,800	35,280	0	65,520
8	2,016,000	100,800	2,016,000	100,800	155,077	100,800	35,280	0	65,520
9	2,016,000	100,800	2,016,000	100,800	155,077	100,800	35,280	0	65,520
10	2,016,000	2,116,800	0	2,116,800	3,256,615	2,116,800	35,280	331,200	1,750,320

### Assumptions

Business value	\$8,000,000	Note term (years)	10
Ownership interest to be sold	40%	Note interest rate	5%
Value of ownership interest	\$3,200,000	Seller's income tax rate	35%
Less minority discounts	30%	Seller's capital gains rate	20%
Sales price	\$2,240,000	Seller's basis	\$1,000,000
Down payment	\$224,000	Buyer's income tax rate	35%
Note value	\$2,016,000		

\* Work with your tax advisor to ensure note interest rates are consistent with current requirements.

### Comments and considerations

- Consider the after-tax cost of buying the business using an interest only note if transferring the business to a family member.
- Consider protecting the sale with life insurance.



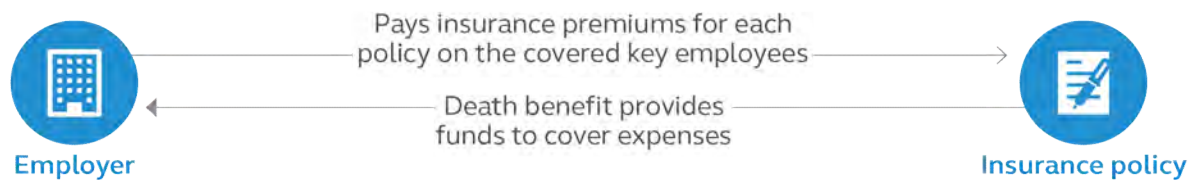
# Buy-sell and succession strategies

## Key person protection

Oftentimes, the most valuable assets of a business are the key people who contribute most to its success. They generate revenue, handle major responsibilities, and have a unique wealth of knowledge that seems irreplaceable. If their loss would create a financial burden that puts the future profitability of the business at risk, a key person insurance policy is a simple and efficient solution.

### How it works

Your business is the owner and beneficiary of a life insurance policy for each key employee chosen, which can include business owners. If the unexpected happens, the business receives funds, generally income tax-free, to help overcome the financial challenges of the loss.



### Comments and considerations

- Identify the employees who are key to your business.
- Consider obtaining key person insurance on your key employees.



# Buy-sell and succession strategies

## Key person retention

### Plans for select key employees

A nonqualified supplemental retirement plan is an effective tool to help recruit, reward, retain, and retire key employees. When properly designed and financed, these plans can help select key employees reduce the challenges created by qualified plan limits. These solutions can also be tailored to meet the needs of both the business and the plan participants.

Offering one of these plans for key employees can help:

- Enhance your total benefits package by offering a financial reward.
- Encourage loyalty by helping to secure the financial future of key employees.
- Motivate key employees to grow the business.
- Benefit from simplified government reporting and disclosure rules – or none at all.

### Considerations for common nonqualified plans

Retaining top hat employees	Retaining non-top hat employees	Obtaining a current tax deduction for company	Obtaining a tax deferral for the key employee
Bonus with Restrictive Agreement	Bonus with Restrictive Agreement	Bonus - Single Bonus - Double Bonus - Simulated deferral	Bonus - Simulated deferral
Loan Split Dollar	Loan Split Dollar		Deferred Comp - Select Reward
Deferred Comp - Select Reward	Deferred Comp - Select Reward		Deferred Comp - SERP
Deferred Comp - SERP	Deferred Comp - Incentive Bonues		Deferred Comp - Defined Contribution
Deferred Comp - Defined Contribution			
Deferred Comp - Defined Benefit			

### Comments and considerations

- Discuss with your tax and legal counsel whether a key person retention plan can be beneficial to your business.



# Retirement income

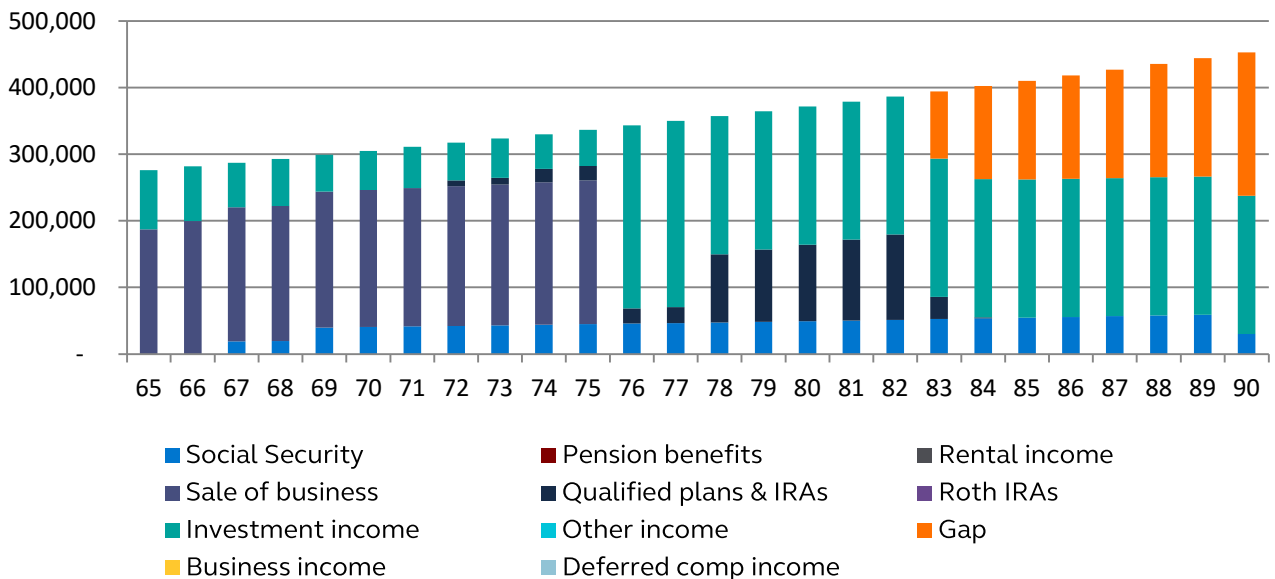
## Business owner retirement analysis

Let's look at your retirement income potential applying the proceeds from the sale of your business and other savings. Based on the information you provided, we've put together the following analysis:

### Assumptions

Current age	60	Qualified plans and taxable IRAs	\$400,000
Spouse's age	58	Annual qualified plan contributions	\$0
Retirement age	65	Roth IRA balance	\$0
Mortality age	90	Annual Roth IRA contributions	\$0
Desired annual income	\$250,000	Investment account balance	\$500,000
Annual Social Security income	\$30,000	Annual investment contributions	\$0
Age to begin Social Security	67	Deferred compensation income	\$0
Spouse Social Security income	\$30,000	Other income	\$0
Age to begin Social Security	67	Pre-retirement rate of return	5.0%
Rental income	\$0	Post-retirement rate of return	5.0%
Business income	\$400,000	Inflation rate	2.0%
Pension income	\$0	Federal and state income tax rate	35%

**Your retirement gap at age 65 is \$417,881**



### Comments and considerations

- Based on the information you provided, you may not have enough savings and income-producing assets to support your retirement income goals.
- Consider qualified retirement plan and nonqualified plan options.
- Consider additional savings and strategies for supplementing your income.



# Retirement income

## Supplemental and retirement income financing options

Your family business will likely play a key role in providing income in retirement, either through rental income or your continued employment. A supplemental retirement plan may provide you with necessary additional income; which can be funded in a variety of ways. Diversifying your income sources based upon timing and income tax characterization can also be beneficial. See advantages and disadvantages of common financial tools below.

**Investments** | Financial vehicles such as stocks, bonds, CDs or mutual funds.

Advantages	Disadvantages
<ul style="list-style-type: none"> <li>● Long-term gains taxed at capital gain rates</li> <li>● Flexible contributions</li> <li>● Many investment options</li> </ul>	<ul style="list-style-type: none"> <li>● Earnings taxable to owner annually</li> <li>● No insurance death benefit</li> <li>● Distributions are treated as part basis, part gain</li> </ul>

**Annuities** | Premiums into an annuity contract — fixed, indexed or variable.

Advantages	Disadvantages
<ul style="list-style-type: none"> <li>● Earnings accumulate tax-deferred</li> <li>● No medical underwriting</li> <li>● Guaranteed death proceeds bypass probate process</li> <li>● Can provide a guaranteed income for life</li> </ul>	<ul style="list-style-type: none"> <li>● Surrender charges may apply<sup>1</sup></li> <li>● Income in respect of decedent at death</li> <li>● 10% penalty on earnings distributed prior to age 59 1/2</li> <li>● Has fees and expenses</li> <li>● Distributions are "gain first" (taxable at ordinary income tax rates), unless annuitized</li> </ul>

**Life insurance** | Premiums into a life insurance policy — fixed, indexed or variable.

Advantages	Disadvantages
<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>2</sup></li> <li>● Tax-free life insurance proceeds may bypass probate process and protect dependents</li> </ul>	<ul style="list-style-type: none"> <li>● Mortality cost of insurance</li> <li>● Underwriting process</li> <li>● Owner may not be insurable</li> <li>● Policy fees and expenses</li> <li>● Impact of loans and withdrawals<sup>2</sup></li> </ul>

**Investing in mutual funds, variable annuities or variable life insurance involves risk, including the potential for loss of principal. Guarantees are based on the claims-paying ability of the issuing insurance company.**

<sup>1</sup> If the contract has surrender charges, withdrawals beyond the free withdrawal provision may have an additional charge.

<sup>2</sup> Withdrawals and loans taken from life insurance policies classified as modified endowment contracts may be subject to income tax and may also be subject to federal tax penalty if the withdrawal or loan is taken prior to age 59½. Withdrawals and loans will also reduce the policy cash surrender value and may cause the policy to lapse. Lapse of a life insurance policy can cause loss of death benefit and adverse income tax consequences.

### Comments and considerations

- A cash value life insurance policy can provide supplemental retirement income and provide a lump sum benefit upon your death.
- Consider whether investments, annuities, and/or a life insurance policy are best suited for your supplemental retirement income needs.





# Retirement income

## Chronic illness protection

You can help protect your family from the hardships of a serious, long-term illness. Some life insurance policies have a rider that allows you to access part of your policy's death benefit if you're diagnosed with a chronic illness. The money could be used to help:

- Pay for quality care
- Cover medical expenses not paid by insurance
- Protect your retirement savings
- Stay more financially secure
- Live your best life possible



Someone turning age 65 today has almost a **70%** chance of needing some type of **long-term care services** and supports in their remaining years.<sup>1</sup>

<sup>1</sup> LongTermCare.gov, as of February 2020



About **80%** of **older adults** have one chronic disease.<sup>2</sup>

<sup>2</sup> NCOA Healthy Aging Fact Sheet, July 10, 2018



Nearly **70%** of **Medicare beneficiaries** have two or more chronic diseases.<sup>2</sup>

### Comments and considerations

- A chronic illness can interfere with retirement, succession and estate plans.
- You indicated that you're concerned about a chronic illness.
- Consider purchasing a life insurance policy which includes provisions to protect you in case of a chronic illness.



# Legacy and estate planning

## Wills and trusts

Estate planning is important for both married and single people, to distribute your personal and business assets. It can also help minimize the impact of taxes and expenses while maximizing distributions to heirs.

Preservation techniques involve both estate and business planning. Many effective techniques are available to successfully help protect and transfer your assets.

### Medical power of attorney

#### **You reported that you do not have a medical power of attorney.**

A medical power of attorney names an “attorney-in-fact” to make medical decisions on your behalf upon physician certification that you are unable to do so. Your attorney-in-fact has a legal obligation to always act in your best medical interest. Therefore, no court-appointed guardian is necessary to make such decisions.

### Financial power of attorney

#### **You reported that you are unsure if you have a financial power of attorney.**

A financial power of attorney provides a designated person, your “attorney-in-fact,” authority to make financial decisions on your behalf at your discretion either [a] immediately; or [b] upon physician certification that you are unable to do so. In the absence of a financial power of attorney, a court conservatorship proceeding would be necessary to appoint a representative conservator to make your financial decisions in the event you could not do so.

### Living will

#### **You reported that you are unsure if you have a living will.**

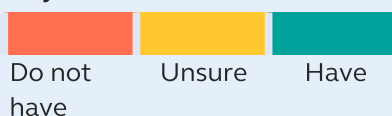
A living will is a legal document that explains your end of life care instructions regarding pain medication, artificial life support, and resuscitation efforts. This document relieves your family from having to make these difficult decisions by obligating your health care provider to follow these previously written instructions.

### Will

#### **You reported that you have a current will in place.**

A will allows you to direct how your assets will be distributed after your death. With a will, a judicial “probate” is likely required to settle your affairs. Consult with your legal and tax advisors whether additional planning may be appropriate.

#### Key:





# Legacy and estate planning

## Wills and trusts (continued)

### Revocable trust

#### **You reported that you do not have a revocable trust.**

A revocable trust, when properly funded, owns your assets for your personal use and control during your lifetime. This trust can be amended any time before you pass away and, upon your death, the trust assets pass outside of judicial probate and provide additional flexibility to your distribution plan. A common mistake is to fail to re-title or transfer assets into the trust. As a result, the assets that you intended to pass outside of judicial probate end up there anyway. Confirm with your legal and tax advisors that your trust has been properly funded.

### Family trust

#### **You reported that you are unsure if you have a family trust.**

A family trust, also known as a bypass or credit shelter trust, is used by married couples to minimize the estate taxes payable. This arrangement is one of the strategies that can help both spouses fully utilize their estate tax exemption, though it is not the only strategy for doing so. Upon the death of the first spouse, the family trust receives assets from the deceased up to the amount that is exempt from estate tax under current law. This trust typically pays income for life to the surviving spouse. Assets inside a family trust are typically outside the reach of the surviving spouse's creditors. Upon the death of the surviving spouse, any remaining assets are distributed to the heirs without being included in the surviving spouse's estate.

### Irrevocable life insurance trust

#### **You reported that you do not have an irrevocable life insurance trust (ILIT).**

An ILIT is an irrevocable trust that owns a life insurance policy on your life. The objective is to exclude the death benefit from your estate for federal estate tax purposes and, ultimately, funnel the death proceeds to your beneficiaries or pay other debts. Because it is irrevocable, it can be very difficult to undo once put into place.

### Estate distribution plans

#### **You reported that you have a distribution plan.**

You reported your distribution plan attempts to treat heirs as fairly as possible. This means the inheritances might not be exactly equal. This distribution plan may result in a great deal of negotiations between your surviving children/beneficiaries if the assets are not easily divided. This distribution plan, when applied to the unique characteristics of a family business, can result in family conflict and litigation.

#### **Comments and considerations**

- You reported that your estate plans do not include:
  - a medical power of attorney, a revocable trust, or an irrevocable life insurance trust.
- Consult with local counsel about reviewing/updating your estate plans.



# Legacy and estate planning

## Inheritance equalization

It's probably important to you to treat your children equally when leaving an inheritance. But, if a large portion of your estate is your business, you may feel like you're trying to divide the indivisible. While the inheritance you leave each child might not be identical and equal, it can still be fair and equitable.

First, decide what legacy you want to leave, and what fair looks like (because only you can). And if you can't leave an inheritance you think is fair without risks to the future success of the business, the use of life insurance can help. It will allow you to keep the business intact while ultimately helping to maintain peace in the family.

### How it works

You determine the amount of your business and non-business assets, and what fair distribution looks like to your family. Then calculate how much more is needed to achieve your distribution goal. Life insurance is purchased in the amount needed to make up the difference. Upon your death, the business can go to one or more heirs, and the non-business assets and life insurance benefit goes to the others. Review the current and proposed plans below to see how adding life insurance to your estate can help you treat your heirs equitably, while keeping your business intact.

### Current plan

Type	Total	Child #1	Child #2	Child #3	Child #4			
Business assets	\$8,000,000	50%	0%	0%	50%	0%	0%	0%
Other assets	\$4,500,000	0%	50%	50%	0%	0%	0%	0%

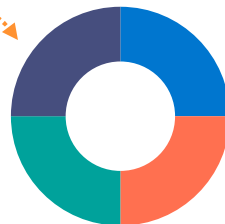
### Proposed plan

Type	Total	Child #1	Child #2	Child #3	Child #4			
Business assets	\$8,000,000	50%	0%	0%	50%	0%	0%	0%
Other assets	\$4,500,000	0%	50%	50%	0%	0%	0%	0%
<b>New insurance</b>	<b>\$3,500,000</b>	<b>0%</b>	<b>50%</b>	<b>50%</b>	<b>0%</b>	<b>0%</b>	<b>0%</b>	<b>0%</b>

### Current plan



### Proposed plan



- Child #1
- Child #2
- Child #3
- Child #4

### Comments and considerations

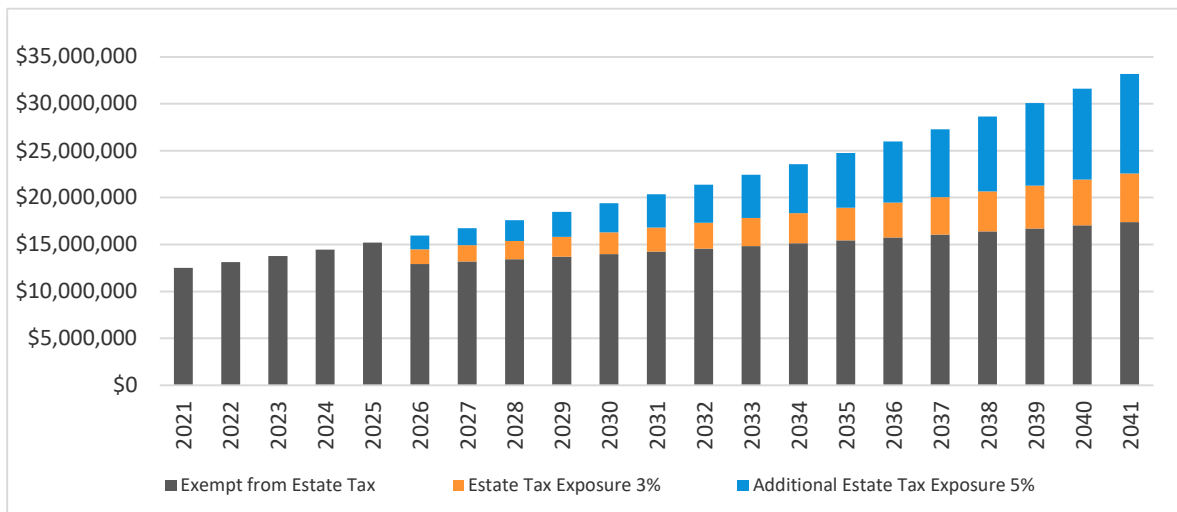
- You indicated that being "fair" is more important than being "equal."
- Consider purchasing life insurance to create fair inheritances among your heirs.



# Legacy and estate planning

## Estate tax protection

Death-related taxes can be devastating to a family business. The 2021 federal estate tax exclusion (which can be passed on without paying federal estate taxes) is \$11,700,000 per person, and \$23,400,000 for married couples (using portability) to combine each married person's respective federal estate tax exclusion. However, these exemptions are temporary and scheduled to sunset, or revert, to \$5,700,000 per person, and \$11,400,000 for married couples. The chart below shows future values and estate projections for an estate worth \$12,500,000 today.



Estate Tax Exemption	Estimated at 3% Growth		Estimated at 5% Growth	
	Estate Value	Estate Tax Exposure	Estate Value	Estate Tax Exposure
2021	\$23,400,000	\$12,500,000	\$0	\$0
2026	\$12,917,745	\$14,490,926	\$5,796,370	\$6,381,408
2031	\$14,262,235	\$16,798,955	\$1,014,688	\$2,439,579
2036	\$15,746,660	\$19,474,593	\$1,491,173	\$4,095,977
2041	\$17,385,585	\$22,576,390	\$2,076,322	\$6,312,255

### Comments and considerations

- Based on the information you provided, your estate might have a federal estate tax liability. As your estate grows, so too will your potential estate tax liability.
- Review these numbers with your tax and legal counsel.
- If you have insufficient funds to cover your federal estate tax liability, it may be necessary to liquidate business assets.
- Consider techniques to minimize potential estate and inheritance taxes.
- Consider a permanent life insurance policy to help pay any federal estate taxes.



# Legacy and estate planning

## Gifting techniques

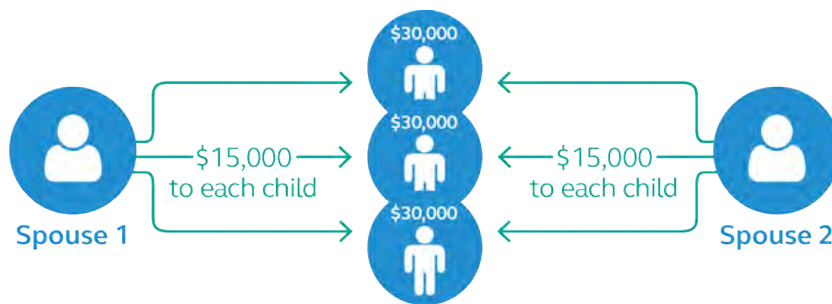
Gifting techniques can help you accomplish a variety of potential estate planning goals:

- Reduce federal estate taxes.
- Facilitate your business succession plan.
- Provide immediate use of the gift.
- Make additional support available to loved ones.
- Move future appreciation out of the taxable estate.

In 2021, the annual gift exclusion amount is \$15,000. This is the amount you can gift without paying federal gift taxes or filing a federal gift tax return. The \$15,000 is per person (donee), per year. There isn't a limit to how many people you can gift to each year. And if you're married, your spouse has the same annual gift exclusion, so you could gift a combined \$30,000 to each person in 2021.

### Example

A married couple with three children could gift \$90,000 annually.



### Your scenario

Number of donors	Your number of beneficiaries	2021 annual gift exclusion amount	Combined annual gift exclusions
2	3	\$15,000	\$90,000

Using this gifting method, you could possibly remove \$90,000 worth of potentially taxable assets from your estate and transfer it to your children/heirs without paying any federal gift tax.

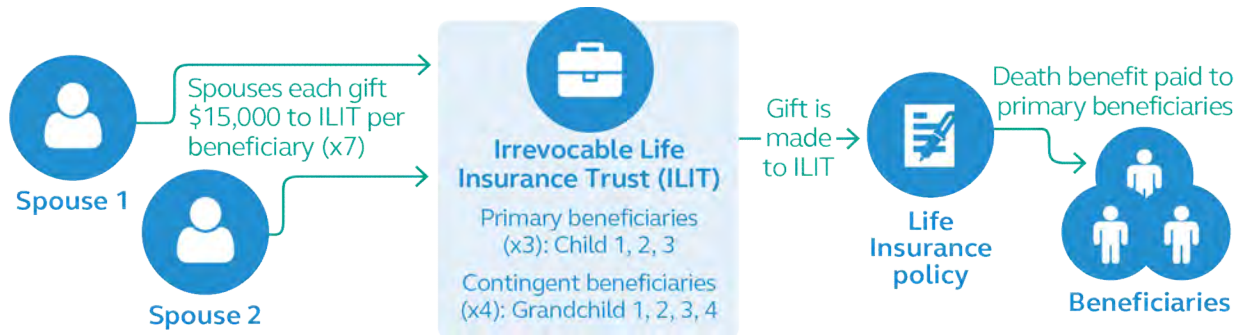




# Legacy and estate planning

## Gifting techniques (continued)

Another common use of the gift exclusion is to fund life insurance premium payments for a policy inside an irrevocable life insurance trust (ILIT). This creates a federal estate tax-free and income tax-free death benefit for the beneficiaries.



### Hypothetical example

Year	Annual exclusion gifts			Gift to trust and hold as investment		Gift to trust and purchase life insurance		Difference	
	Number of donors	Number of donees	Annual exclusion amount	Total annual gift	Annual investment	Trust assets after 5% growth	Annual life insurance premiums	Life insurance death benefit	Additional benefit to heirs
1	2	3	\$ 15,000	\$ 90,000	\$ 90,000	\$ 90,000	\$ 90,000	\$ 6,053,071	\$ 5,963,071
5	2	3	\$ 15,000	\$ 90,000	\$ 90,000	\$ 522,172	\$ 90,000	\$ 6,053,071	\$ 5,530,899
10	2	3	\$ 15,000	\$ 90,000	\$ 90,000	\$ 1,188,611	\$ 90,000	\$ 6,053,071	\$ 4,864,460
15	2	3	\$ 15,000	\$ 90,000	\$ 90,000	\$ 2,039,174	\$ 90,000	\$ 6,053,071	\$ 4,013,897
20	2	3	\$ 15,000	\$ 90,000	\$ 90,000	\$ 3,124,733	\$ 90,000	\$ 6,053,071	\$ 2,928,338

This assumes purchase of \$6,053,071 life insurance policy for \$90,000 annual premiums. For Preferred Non-Tobacco, male age 68 and Preferred, Non-Tobacco, Female age 68, the death benefit is guaranteed until the youngest insured's age 100. Not valid without accompanying insurance illustration. Please see illustration for important information.

### Comments and considerations

- Consider using your annual gift exclusions to gift business interests. As the annual gifts accumulate over time, a substantial portion of your business can be transferred from your taxable estate to your successors, without incurring gift taxes.
- Alternatively, consider using your annual gift exclusions to pay life insurance premiums for a policy owned by an ILIT. These income tax-free death benefits can be used towards estate debt reduction and/or other needs.

# Your customized planning considerations

We're here to help you achieve your goals. We understand that some of your goals are more important to you than others so make sure to let us know which issues are priorities so we can focus our attention and your resources there first.



## Buy-sell and succession strategies

### Informal business valuation

- Understand your business value and how this relates to your business succession plans.
- Explore whether a complimentary informal business valuation from Principal is appropriate for you.

Priority Target date


### Buy-sell planning

- Consider establishing a buy-sell agreement with your successor.
- Based on the information provided, discuss with local counsel whether a buy-sell agreement will help facilitate the succession of your business.


### Buy-sell funding

- Consider fully funding the buy-sell agreement with life insurance.
- Consult with your advisors about what type of insurance will best meet your needs.


### Entity discounting

- You would like to transition the business using entity discounting.
- Please consult with your tax and legal advisors about appraising the value of any gifts and determining the appropriate discounts (if any).




## Succession funding

### Key person protection

- Identify the employees who are key to your business.
- Consider obtaining key person insurance on your key employees.


### Key person retention

- Discuss with your tax and legal counsel whether a key person retention plan can be beneficial to your business.

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# Your customized planning considerations

(continued)



## Retirement income

### Business owner retirement analysis

- Based on the information provided, you may not have enough savings and income-producing assets to support your retirement income goals.
- Consider qualified retirement plan options.
- Consider key employee benefit options.
- Consider additional savings and strategies for supplementing your income.

### Financing options

- Consider whether investments, annuities, and/or a life insurance policy is best suited for supplementing your retirement income needs.

### Chronic illness protection

- You indicated that you are concerned about a chronic illness. Consider purchasing a life insurance policy which provides protection for a chronic illness.

Priority Target date


# Your customized planning considerations (continued)



## Legacy and estate planning

### Wills and trusts

- Consult with local counsel about reviewing/updating your estate plans.

Priority	Target date

### Inheritance equalization

- You indicated that being "fair" is more important than being "equal".
- Consider purchasing a life insurance policy to create fair inheritances among your heirs.


### Estate tax protection

- Continue to monitor your estate over time. As your estate grows, so will your potential estate tax liability.
- Consider techniques to minimize potential estate and inheritance taxes.
- Consider a permanent life insurance policy to help pay any federal estate taxes your estate may incur.


### Gifting techniques

- Consider using your annual gift exclusions to gift business interests.
- Alternatively, consider using your annual gift exclusions to pay life insurance premiums for a policy owned by an ILIT. These income tax free death benefits can be used towards estate taxes, inheritance equalization, debt reduction and/or other needs.


# Your goals, our purpose

**No matter what's important to you, Principal is here to help you identify and implement solutions that are right for your needs.**

We help family business owners protect and achieve their financial dreams through financial solutions that can help them live their best lives.

We work with people like you every day and make it a priority to understand where you want to be and help you plan to get there. This means you'll get expertise and innovative ideas when you need them to make your financial progress possible. Our life insurance solutions have been protecting people for more than a century. And by working with a Top 20 provider of life insurance, you'll know you're in good company. From basic, affordable protection to more robust solutions for long-term needs, you'll find coverage to fit your situation.

Our leadership in delivering insurance protection solutions for individuals, employers, and their key people runs deep. Our comprehensive product portfolio, paired with unique and flexible plan designs, mean you get solutions tailored to your specific needs.

## **Work with a leader**

- No. 1 provider of nonqualified deferred compensation plans.<sup>1</sup>
- No. 2 provider of non-cancelable individual disability income insurance.<sup>2</sup>
- No. 3 provider of group benefit insurance (dental, life and disability).<sup>3</sup>
- A leader in the business market and a Top 20 life insurance provider.<sup>4</sup>

<sup>1</sup> Based on number of Section 409A plans, PLANSPONSOR Recordkeeping Survey, July 2020.

<sup>2</sup> LIMRA, February 2020.

<sup>3</sup> Based on 2019 LIMRA data on fully insured employer contracts in force, May 2020.

<sup>4</sup> LIMRA Individual Life New Sales, February 2020.

## Appendix - Retirement income sources

Client age	Annual need	Soc Sec & pension	Rental income	Business income	Sale of the business	Qualified plans & IRAs	Investment income	Deferred comp and other income	Gap
65	\$276,020	\$0	\$0	\$0	\$187,200	\$0	\$88,820	\$0	\$0
66	\$281,541	\$0	\$0	\$0	\$199,469	\$0	\$82,071	\$0	\$0
67	\$287,171	\$19,039	\$0	\$0	\$200,958	\$0	\$67,174	\$0	\$0
68	\$292,915	\$19,420	\$0	\$0	\$202,520	\$0	\$70,974	\$0	\$0
69	\$298,773	\$39,617	\$0	\$0	\$204,161	\$0	\$54,995	\$0	\$0
70	\$304,749	\$40,410	\$0	\$0	\$205,884	\$0	\$58,455	\$0	\$0
71	\$310,844	\$41,218	\$0	\$0	\$207,693	\$0	\$61,932	\$0	\$0
72	\$317,060	\$42,042	\$0	\$0	\$209,593	\$9,120	\$56,306	\$0	\$0
73	\$323,402	\$42,883	\$0	\$0	\$211,587	\$9,924	\$59,007	\$0	\$0
74	\$329,870	\$43,741	\$0	\$0	\$213,681	\$20,467	\$51,981	\$0	\$0
75	\$336,467	\$44,616	\$0	\$0	\$215,880	\$21,849	\$54,122	\$0	\$0
76	\$343,196	\$45,508	\$0	\$0	\$0	\$22,904	\$274,784	\$0	\$0
77	\$350,060	\$46,418	\$0	\$0	\$0	\$23,934	\$279,708	\$0	\$0
78	\$357,062	\$47,346	\$0	\$0	\$0	\$102,313	\$207,402	\$0	\$0
79	\$364,203	\$48,293	\$0	\$0	\$0	\$108,507	\$207,402	\$0	\$0
80	\$371,487	\$49,259	\$0	\$0	\$0	\$114,825	\$207,402	\$0	\$0
81	\$378,917	\$50,244	\$0	\$0	\$0	\$121,270	\$207,402	\$0	\$0
82	\$386,495	\$51,249	\$0	\$0	\$0	\$127,843	\$207,402	\$0	\$0
83	\$394,225	\$52,274	\$0	\$0	\$0	\$33,532	\$207,402	\$0	\$101,016
84	\$402,109	\$53,320	\$0	\$0	\$0	\$1,535	\$207,402	\$0	\$139,853
85	\$410,151	\$54,386	\$0	\$0	\$0	\$0	\$207,402	\$0	\$148,363
86	\$418,355	\$55,474	\$0	\$0	\$0	\$0	\$207,402	\$0	\$155,478
87	\$426,722	\$56,583	\$0	\$0	\$0	\$0	\$207,402	\$0	\$162,736
88	\$435,256	\$57,715	\$0	\$0	\$0	\$0	\$207,402	\$0	\$170,139
89	\$443,961	\$58,869	\$0	\$0	\$0	\$0	\$207,402	\$0	\$177,690
90	\$452,840	\$30,023	\$0	\$0	\$0	\$0	\$207,402	\$0	\$215,415

This chart is for illustrative purposes only and is made available as a self-help resource for your planning convenience. Retirement income sources are calculated on an after-tax basis. The results are based on your inputs and are not intended to be a financial plan or investment advice from Principal but may be used as a general guideline to help you make personal planning and financial decisions. Responsibility for these decisions is assumed by you, not Principal. All projections, analysis and calculation results are estimates and depend on many factors, including the data and assumptions you provide, and may not reflect all your sources of income or expenditures. Actual results may vary and do not represent the returns of any particular investment.



[principal.com](http://principal.com)

The previous pages depict certain business planning options. All of these options are based on the information you shared with us for this purpose and the assumptions stated throughout the report. Of course, any variance in the information or assumptions could change the results.

All assets assume specific growth rates, calculated based on information from the client. These individual rates are used to project the possible growth of the business. These projections are made to estimate future business insurance needs. Although the informal business valuation from Principal can provide a valuable starting point in helping you determine the value of your business, the valuation will not be a substitute for a formal valuation nor does it establish a value for tax purposes. A formal valuation should be constructed with the guidance of your legal and/or tax advisors.

Solutions outlined in this report do not imply a recommendation that a specific business planning option should be implemented. Rather it represents a summary of potential considered strategies, which each individual should discuss with his or her tax advisor, attorney, and/or other professional advisor before taking any action.

Because your business planning goals may change in the future, periodic monitoring should be an essential component of your program.

Disability income insurance has certain limitations and exclusions. For costs and complete details of coverage, contact your Principal Life financial representative. Individual disability income insurance Series 700. Not all products available in all states.

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