

Individual Disability Insurance

Disability Buy-Out Planning

For Business Owners

Principal

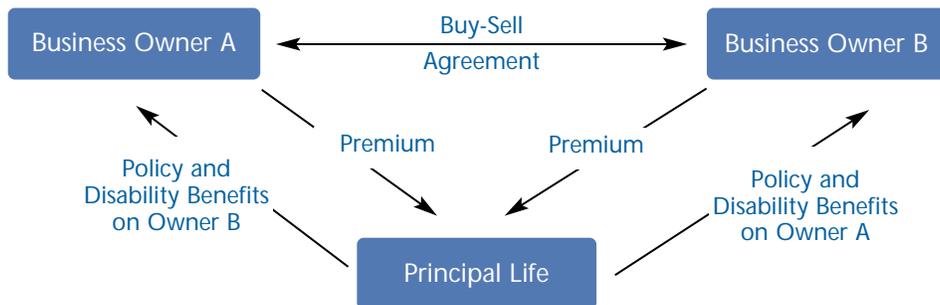
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WE UNDERSTAND WHAT YOU'RE WORKING FORSM

How Buy-Sell agreements work



Cross Purchase Agreement

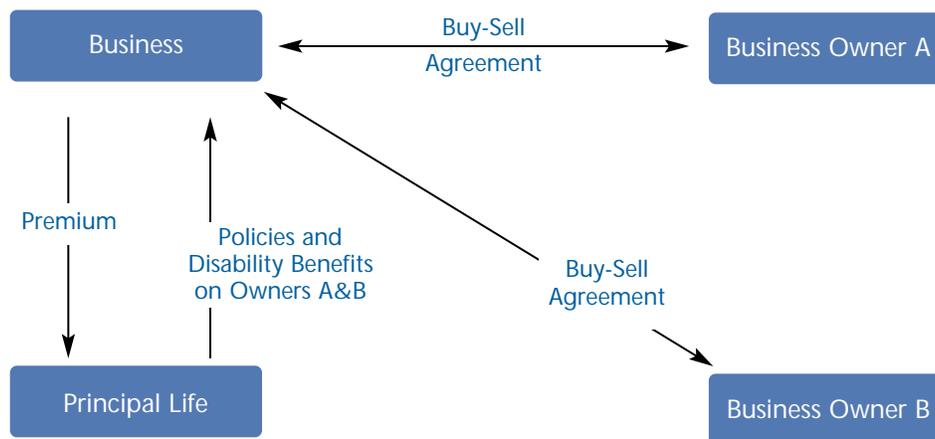


Each business owner purchases and owns a Disability Buy-Out policy on each of the other business owners. (This arrangement may require business owners to purchase and maintain several policies if there are more than two owners.)

IF A BUSINESS OWNER BECOMES TOTALLY AND PERMANENTLY DISABLED:

- The non-disabled owners purchase the business interest of the disabled owner in accordance with the existing Buy-Sell Agreement and receive policy benefits (up to the policy limit) as reimbursement.
- The non-disabled owners then own the business, and the disabled owner has been paid the price agreed upon.

Entity Purchase Agreement



The business purchases and owns a Disability Buy-Out policy on each business owner.

IF A BUSINESS OWNER BECOMES TOTALLY AND PERMANENTLY DISABLED:

- The business purchases the business interest of the disabled owner in accordance with the existing Buy-Sell Agreement and receives policy benefits (up to the policy limit) as reimbursement.
- The non-disabled owners then own the business, and the disabled owner has been paid the price agreed upon.

Disability Buy-Out insurance

ADVANTAGES OF USING DISABILITY BUY-OUT INSURANCE TO FUND BUY-SELL AGREEMENTS

- It assures adequate funding for the purchase of a disabled business owner's interest in accordance with the Buy-Sell Agreement.
- It avoids an adverse impact on working capital and the credit position of the business, and reduces the need or pressure to liquidate other assets to generate cash.
- It can cover a funding need that may occur soon after the creation of the Buy-Sell Agreement.

TAX CONSEQUENCES

- Premiums are not deductible. IRC Section 264(a)(1) and Rev. Rul. 66-266.
- Disability benefits paid to the business (entity purchase) or to the non-disabled business owners (cross purchase) are received income tax-free. IRC Section 104(a)(3).
- Sale proceeds equal to the excess of sale price over basis are taxed to the disabled business owner at capital gain rates in the year payments are received. No step-up in basis is available.
- Sale proceeds represented by unrealized receivables, substantially appreciated inventory and depreciation recapture (partnerships), or by an incomplete redemption of a shareholder's stock (corporations), are taxed to the disabled business owner as ordinary income.

Buy-Sell agreements

A Buy-Sell Agreement funded with Disability Buy-Out Insurance ensures a market for a closely-held business interest upon the total and permanent disability of an owner.

ADVANTAGES TO THE ACTIVE BUSINESS OWNERS

- Avoids disagreements arising from the negotiation of the sale price.
- Avoids involving the disabled owner and his or her family in the management of the business.
- Assures smooth transition and complete retention of management and control of the business interest.
- Maintains business continuity and credibility, which are concerns of customers, creditors and employees.
- Guarantees a competitor cannot purchase the business interest of the disabled owner.

ADVANTAGES TO THE DISABLED BUSINESS OWNER

- Creates an automatic market by guaranteeing a definite and fair price and a buyer for the business interest.
- Provides money which may be needed to pay medical bills and living costs.
- Assures that his or her financial future is no longer contingent upon the strength of the business.

The Principal[®]

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- Established in 1879
- A *FORTUNE 500*[®] company
- Ranks in the top one percent of all U.S. domestic life insurers based upon total assets¹
- Diverse operations including individual insurance, pension plans and group/employee benefits
- More than 13 million individuals and their families served. More than 75,000 group employer clients and 40,000 pension customers (employers)
- More employers choose the Principal Financial Group for their 401(k) plans than any other insurance company, bank or mutual fund in the United States²
- Member of IMSA. Membership promotes ethical market conduct for individual life insurance and annuities
- Proud supporter of the National Association of Women Business Owners (NAWBO)

¹Source: A.M. Best's 2000 Life Sales Results – Best's Sales Studies

² CFO Magazine, April 2002

This material is believed to provide accurate and authoritative information regarding the subject matter covered. It is provided with the understanding that Principal Life is not rendering legal, accounting or tax advice. In specific cases, clients should consult their legal, accounting or tax advisors.

Disability income insurance has limitations and exclusions. For costs and complete details of coverage, contact your Principal Life representative.

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