

Explanation of the 2009 Tax Form(s) You Have Received

The information provided is intended for your use as an individual taxpayer. This document primarily focuses on the various tax forms you have received and should not be construed as specific tax advice. We urge you to consult your tax and legal advisors regarding your specific tax questions and any strategies you may be considering.

Year-End Account Statement

Mailed in early January and reflects all account activity for the year in addition to the value of your accounts at year end. All IRA shareholders will find the total account value as of December 31, 2009, on their year-end account statement.

Form 1099-DIV

This form contains distribution information for each account with gross distributions of more than \$10 or for any account from which federal income tax has been withheld. It will include taxable ordinary dividends and capital gains. If applicable, amounts of backup withholding and foreign tax paid will also be reported.

*See exemption notice below.

Form 1099-B

This form provides information on redemptions and exchanges of shares out of an account for use in calculating your gain or loss on these transactions. Cost Basis information based on an Average Cost calculation is also included if this information is available. The Cost Basis information is not being reported to the IRS.

(Principal Funds, Inc. Money Market Fund shareholders please note: Because the share price for this fund was maintained at \$1, redemptions from these accounts did not generate a gain or loss and, therefore, are not reportable on Form 1099-B.)

*See exemption notice below.

***EXEMPTIONS FROM RECEIVING FORM 1099-DIV and FORM 1099-B**

The IRS does not require that these forms be issued for certain accounts. Examples of such accounts include IRAs, qualified pension and profit-sharing plans, corporations and accounts owned by certain tax-exempt or financial institutions.

Tax Reporting Supplement

This information will be located online at www.PrincipalFunds.com or by calling our Client Contact Center at 1-800-222-5852, Monday – Friday, 7 AM to 7 PM CT

Form 1099-R

This form provides information for each retirement account that had a distribution (full or partial) processed for the tax year. The form also provides information on any taxes withheld from those distributions.

Form 1099-Q

This form provides information for each Coverdell ESA account that had a distribution or a Trustee-to-Trustee transfer or rollover.

Form 1099-INT

You should receive this statement if you have an account in one of our tax-exempt funds. This statement provides the amount of federal tax-exempt dividends and the amount of income subject to alternative minimum tax.

If your fund earned both taxable and nontaxable income, you will receive Form 1099-DIV and the 1099-INT.

Form 1099 SA

This form provides information for each Medical Savings Account and reports all redemptions of shares out of the account.

Form 1042-S

This form is mailed by March 15th. You should receive Form 1042-S if you are a foreign citizen or represent a foreign corporation. This form provides the gross income and tax withheld to help prepare tax returns for non-resident aliens.

Form 5498

This form is mailed by May 31 and reports the previous tax year's IRA contributions, including rollovers and fair market value as of December 31.

Please note that Form 5498 issued by Principal Funds on behalf of SEP, SAR/SEP, SIMPLE IRA, and 403(b) accounts reflects total contributions made in the 2009 calendar year regardless of tax year.

Form 5498-ESA

This form is mailed by April 30 and reports the previous tax year's Coverdell ESA contributions, rollovers, Trustee-to-Trustee transfers and fair market value as of December 31.

Form 5498-SA

This form is mailed by May 31 and reports the previous tax year's contributions to Medical Savings Accounts including rollovers and fair market value as of December 31.

ANSWERS TO FREQUENTLY ASKED QUESTIONS**What are capital gains and losses?**

In addition to gains distributed to you from the sale of securities in a fund's portfolio, you also may have taxable gains from selling your fund shares. If you sell your shares for more than their original cost, you may have realized a capital gain. If you sell them for less, a capital loss may result. In general, any redemption or exchange of shares is considered a sale of shares.

What is the difference between short-term and long-term gains and losses?

Gains and losses on mutual fund shares held for one year or less are considered short-term; shares held for more than a year are deemed long-term. Short-term capital gains are included with your other ordinary income and are taxable at your marginal tax rate. Long-term capital gains are taxable as such (generally at a 15% tax rate.).

What is cost basis?

In order to determine a capital gain or loss when you sell or exchange shares, you need to calculate a share cost or cost basis of the shares sold. The basis is how much the shares sold cost when you bought them. If you redeemed shares in your Principal Funds account you may receive cost basis information on Form 1099-B to assist you in this calculation. The IRS allows you to choose one of four methods to determine this amount. Note: Once you select a method for a particular fund, you must use the same method for subsequent sales of shares of that fund.

What are 1099-R distribution codes?

You will find information regarding distribution reason codes on the reverse side of the Form 1099-R.

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