

Direct Sellers

Contents

Overview of Direct Selling.....	Page 3-15
Income From Sales.....	Page 3-16
Other Income.....	Page 3-18
Home Meetings.....	Page 3-18
Business Use of the Home.....	Page 3-19
Meals and Entertainment.....	Page 3-19
Transportation.....	Page 3-20
Business Gifts.....	Page 3-21
Start-Up Expenses.....	Page 3-21
Not-for-Profit Limit.....	Page 3-22
Involvement of the Direct Seller's Spouse.....	Page 3-22
Reporting Requirements.....	Page 3-24
Tax Organizer—Direct Sellers.....	Page 3-25

Quick Tax Briefing


Overview

Direct sellers are treated as self-employed for tax purposes, regardless of whether they would be considered an employee under the common law tests typically used to determine employee status. Therefore, their net business income is subject to both income and self-employment tax.

Tax highlights

- ✓ Direct sellers may receive taxable compensation in the form of prizes, such as goods, trips or free use of a car.
- ✓ Many direct sellers have another job. Therefore, they may have to prove that their direct selling activity is a business, rather than a hobby, if it incurs a loss.
- ✓ Direct sellers often use their home for their business. If they store inventory there, they may be entitled to favorable rules for deducting expenses related to the business portion of their home.
- ✓ Direct sellers who acquire goods for resale (inventory) must keep track of goods purchased, sold and used for personal purposes each year.

IRS materials

- IRS Pub. 587, *Business Use of Your Home*.
- Audit Technique Guide (ATG): *Retail Industry*.
 **Note:** The Retail Industry ATG (Revision 2/2009) is being revised. The old ATG has been removed and the new ATG will be posted on the IRS website as soon as it is completed and approved for publication.

Useful websites

- Direct Selling Association—www.dsa.org.
- World Federation of Direct Selling Associations—<http://wfdsa.org>.

Key Terms

Direct seller. A person who works under contract with a company to sell its products and who meets the definition of a *direct seller* in the Tax Code. Direct sellers are, by definition, self-employed for tax purposes, regardless of whether they would be classified as employees under the common law tests normally used to determine whether an employer/employee relationship exists.

Down-line sales. Sales by a direct seller recruited by a direct seller already under contract with a direct selling company.

Multi-level compensation plan. Direct sellers are compensated based not only on their own product sales, but on the product sales of their down-line sellers.


Single-level compensation plan. Direct sellers are compensated based solely on their own product sales.


OVERVIEW OF DIRECT SELLING

Direct sellers are individuals that meet all three of these tests: [IRC Sec. 3508(b)(2)]

- 1) They are engaged in the trade or business of selling (or soliciting the sale of) consumer products, either (a) in a home or other place that is not a permanent retail establishment or (b) to any buyer on a buy-sell basis or a deposit-commission basis for resale in a home or other place that is not a permanent retail establishment.
- 2) Substantially all of their pay is directly related to sales or other output (including the performance of services) rather than to the number of hours worked.
- 3) Their services are performed under a written contract with the person for whom services are performed and the contract provides that the direct seller will not be treated as an employee for federal tax purposes.



 **Note:** Also included in the definition of a direct seller are individuals who deliver or distribute newspapers or shopping news if tests 2 and 3 above are met. [IRC Sec. 3508(b)(2)]

 **Observation:** Selling consumer products as a company employee does not make a person a direct seller.

Taxation. Individuals who meet the definition of direct sellers are self-employed [IRC Sec. 3508(a)]. This is the case even if the direct seller would be considered an employee under the common law tests typically used to make this determination. Thus, direct sellers report their income and expenses on Schedule C of their Form 1040. They also file Schedule SE to report and pay self-employment tax on the net earnings from their business.

Direct selling companies. Direct sellers usually sign up with a particular company to sell its product line. Some of the larger companies that use direct sellers include:

Company	Products
Mary Kay	Skin care supplies/cosmetics
Avon	Health/beauty supplies
Tupperware	Kitchenware
PartyLite Gifts	Candles and accessories
Pampered Chef	Kitchen tools
Longaberger	Baskets and pottery
Home and Garden Party	Home decorations
Creative Memories	Scrapbook supplies
Stampin Up	Rubber stamps
Discovery Toys	Educational toys

For a more complete (although not all inclusive) listing of direct selling companies, go to the Direct Selling Association website—www.dsa.org.

The company may refer to the direct seller by one of the following titles:

- Consultant,
- Coordinator,
- Dealer,
- Demonstrator,
- Designer,
- Director,
- Distributor or direct distributor,
- Instructor,
- Manager or supervisor,
- Representative or sales representative or
- Independent business owner.



Recruiting. Individuals are in the trade or business of selling or soliciting the sale of consumer products if they attempt to increase the sales of direct sellers who work under them (their down-line group), and their earnings depend in part on how much they sell. Recruiting, motivating and training are examples of attempts to increase sales.

Host or hostess. An individual that simply hosts a party at which sales are made is not a direct seller. Any gift received for giving the party is a payment for helping the direct seller make sales. It must be reported as income at its fair market value. The host or hostess's out-of-pocket party expenses are subject to the 50% limit for meal and entertainment expenses. These expenses are deductible as miscellaneous itemized deductions subject to the 2%-of-AGI limit on Schedule A, but only up to the amount of income received for giving the party.

How Direct Sellers Make Money

There are two ways that a direct seller can earn income:

- 1) They can sell the product and
- 2) They can sponsor/recruit new representatives.

Each company has its own set percentage of commission on direct sales, as well as additional percentages of additional income from their "down-line" sales. These percentages are generally smaller and are based on sales produced by the recruit.

Ⓢ **Observation:** Individuals who work under another direct seller are not that person's employee.

Example: Anna, a direct salesperson receives a 25% commission on personal sales. Once she sponsors/recruits two new consultants, she receives an additional 2% of the recruits' sales each month. If she sponsors/recruits four to six new consultants, this percentage increases to 7%. In addition, if one of her recruits sponsors two new consultants, she can earn 4% of the sales of those new recruits.

In addition to the commission on sales, direct sellers may also receive prizes and awards from the selling business. These are taxable under IRC Sec. 74 (see *Other Income* on Page 3-18).

INCOME FROM SALES

Direct sellers have income from sales if their customers buy directly from them and they buy the products they sell from a company (or another direct seller). Direct sellers who have income from sales must figure their cost of goods sold for each year. (See *Cost of Goods Sold* in the next column.)

Sometimes, customers buy their products directly from the company. If the direct seller receives a commission or bonus for making the sale, that commission is taxable, but it is not sales income. These commissions are reported as other business income. (See *Other Income* on Page 3-18.)

Ⓢ **Observation:** Commissions, bonuses and prizes should be reported to the direct seller as nonemployee compensation on

Form 1099-MISC, box 7. The direct selling company will also check box 9 of the Form 1099-MISC if it sold \$5,000 or more of consumer products to the direct seller for resale. Presumably, the IRS will expect to find at least a certain amount of gross receipts from sales on a direct seller's income tax return in any year he purchased \$5,000 or more of product to sell.

Depending on the company with which the direct seller is affiliated and the nature of its marketing and compensation plan, the direct seller may have income from sales, commissions, bonuses or all three.

Example #1: Kim's customers pay her the retail price for goods they order. She forwards the orders and payments to the company, which sends the merchandise to fill the orders. The company also sends Kim a commission equal to 25% of the order. Kim is acting as a sales agent for the company. She did not purchase the products to sell to her customers. Her payment from the company is commission income, not income from sales. She includes the commission in her gross receipts. The amount her customers pay for the goods they order is not included in Kim's income.

Example #2: Kim's customers pay her a deposit when she takes their orders. She sends the orders to the company, but keeps the deposits for herself. The company fills the orders by shipping the merchandise to Kim's customers, who pay the company the remainder of the retail price (usually cash on delivery). Kim is acting as a sales agent for the company. The deposits she keeps are her commission income. She has no income from sales.

Example #3: Kim's customers pay her for the goods she sells them, either when she takes their orders or when she makes deliveries. After her customers place orders, she orders the goods from the company (or from a direct seller she works under). She either sends the money directly to the company with her orders or is billed later. In either case, she charges her customers more than she pays for the goods. Kim is buying products wholesale and selling them retail. The full amount received from her customers is income from sales.

Example #4: Kim keeps a supply of goods that her customers regularly buy from her. This allows her to fill their orders without delay. She orders and pays for the goods before her customers request them. She has purchased goods to resell to customers. The full amount received from her customers is income from sales.

Example #5: Kim has recruited several other direct sellers who order their products through her. Commissions or bonuses paid to her by the company are shared with the direct sellers in her group based on sales, purchases or some other formula established by the company. Kim keeps the portion of the commissions she is not required to distribute to the direct sellers in her group. The bonuses Kim receives from the company are included in income as commissions, not as income from sales.

Cost of Goods Sold

Direct sellers who have income from sales must compute the cost of goods sold during the year. Generally, this means that they must keep records of the items purchased during the year, and be able to determine the items on hand at the end of the year, either by physically counting them or by keeping a running tally of the items on hand throughout the year (that is, a perpetual inventory system).

Ⓢ **Observation:** Many companies sell software to help direct sellers keep track of their inventory.

Direct sellers whose average annual gross receipts for every year since 1998 are \$1,000,000 or less do not have to account for inventory under the rules of IRC Sec. 471, nor do they have to apply the Section 263A uniform capitalization rules (Rev. Proc. 2001-10, as modified by Announcement 2004-16 and Rev. Proc. 2011-14). (See *\$1 Million Exception* on Page 10-3.) Instead, they may treat inventory as nonincidental supplies. If inventory items are accounted for as nonincidental supplies and the taxpayer is

on the cash method, the cost of the items that would otherwise be included in inventory are deducted the later of the year the items are (1) sold or (2) paid for.

Observation: Most direct sellers will be eligible to use the cash method and treat inventory items as nonincidental supplies because their average annual gross receipts will not exceed \$1,000,000. However, those direct sellers must still be able to identify inventory on hand at the end of the year to compute their cost of goods sold, since items cannot be expensed before the year they are sold.

Whether the taxpayer is accounting for inventory under IRC Sec. 471 or using the nonincidental supplies method, cost of goods sold is generally computed as follows:

Cost of Goods Sold Worksheet		
1) Beginning Inventory	1)	_____
2) Add: Purchases during the year	2)	_____
3) Subtract: Personal withdrawals	3)	< _____ >
4) Subtract: Purchase returns and allowances	4)	< _____ >
5) Equals: Goods available for sale	5)	< _____ >
6) Subtract: Ending inventory	6)	< _____ >
7) Equals: Cost of goods sold	7)	_____

Beginning inventory. This is the cost of goods for sale on hand at the beginning of the year. It will usually be the same as the prior year's ending inventory. Any differences must be explained in a schedule attached to the return.

Purchases. Include the actual cost of all merchandise bought to sell to customers, including postage and freight charges incurred. The actual cost is net of any cash or trade discount received. A cash or a trade discount is the difference between the invoice price and the actual price paid. Likewise, purchase returns and allowances are subtracted from total purchases for the year. Purchase returns and allowances include any rebates or refunds received off the purchase price, as well as any credit received for returned merchandise.



Caution: Cash method taxpayers using the nonincidental supplies method to account for inventory do not include items not paid for at the end of the year.

Merchandise received on consignment is not purchased and is never included in the direct seller's inventory. Direct sellers have merchandise on consignment if they do not have to pay for what they have in stock until they sell it and collect the retail price from the customer.

Personal withdrawals. Direct sellers cannot deduct the cost of items they purchase for personal use or items they withdraw from inventory. Merchandise is considered withdrawn from inventory when it is no longer available for sale to customers. An item is considered to be withdrawn for personal use even if the direct seller uses the product only to become familiar with its characteristics or to demonstrate loyalty to the company whose products he sells.

Ending inventory. Generally, ending inventory is determined by identifying and counting all goods on hand that have not yet sold to customers. Include merchandise that has been purchased, if title has passed to the direct seller, even if he has not yet physically received the goods. Direct sellers may have title to goods that were shipped to them but are still in transit at the end of the year. If the risk of loss during shipment is the direct seller's, he will probably have title to the goods during shipment. If the direct seller buys merchandise that is sent COD, title passes when payment and delivery occur.

Direct sellers may also have title to goods purchased but not yet paid for. If they are billed for merchandise, they usually must pay the bill within a certain time. In this case, they have title to the

goods and must include them in inventory, provided they are not sold by the end of the year.

Caution: Taxpayers using the nonincidental supplies method to account for inventory do not include items not paid for at the end of the year.

After the ending inventory has been counted, the direct seller must identify the cost of the inventory items. Most direct sellers will be able to use the specific identification method to identify and match the actual cost to the items in inventory.

A direct seller who cannot match specific items with their invoices must make an assumption about which items were sold during the year and which remain. This assumption is made using either the first-in first-out (FIFO) method or the last-in first-out (LIFO) method.

Caution: If the nonincidental supplies method is used, the LIFO method cannot be used.

The FIFO method assumes that the first items purchased are the first items sold, consumed or otherwise disposed of.

The last step in figuring ending inventory is to value the inventory items. The two most common methods to value non-LIFO inventory are the cost method and the lower of cost or market method. If the cost method is used to value inventory items, the value of each item is usually its invoice price. Add transportation, shipping and other necessary costs to acquire the items. Subtract appropriate discounts received. See *Lower of Cost or Market (LCM) Method* on Page 10-2 for the details on that method.

Example: Lisa is a direct seller of cosmetics. She has an established clientele and knows what items are steady sellers. When the company has a special sale on these items, she buys extra quantities for future sales. She had \$250 of merchandise on hand at the end of 2015 and merchandise costing \$175 at the end of 2016. During 2016, she purchased and paid for \$3,250 of merchandise. Purchase returns and allowances were \$50. She withdrew \$200 (based on cost) of cosmetics for personal use. Lisa figures her cost of goods sold for 2016 as follows:

Beginning Inventory	\$ 250
Add: Merchandise purchased during the year	3,250
Subtract: Purchase returns and allowances	< 50 >
Subtract: Goods withdrawn for personal use	< 200 >
Equals: Goods available for sale	\$ 3,250
Subtract: Ending inventory	< 175 >
Equals: Cost of goods sold	\$ 3,075

Demonstrators

The cost of products kept on hand to show to potential customers may be part of the cost of goods sold, a capital expense, a business expense or a personal expense, depending on the circumstances. The cost of a product direct sellers use themselves is a personal expense, even if they occasionally show it to prospective customers.

Example: Sandi is a direct seller who uses many of the products in her own home. When potential customers come to her house, she can show them drapes she bought from the company, as well as her lawn chairs, toaster, grill, tea set and spice cabinet. By showing these items in her own home, she hopes to interest people in buying from her company or in becoming direct sellers themselves. Sandi cannot take a deduction for the cost of any of these products. Because she uses them in her own home for personal reasons, their cost is not a cost of doing business.



Used one year or less. If a direct seller has a product used as a demonstrator for one year or less and the demonstrator itself is not available for purchase by customers, its cost is a business expense. If the demonstrator can be bought by customers, it should be included in inventory.

Example #1: Constance is a direct seller of kitchenware. Customers must order items from a catalog, but she keeps at least one of each type on hand to show buyers. When her product line changes and an item is discontinued, she either starts using the demonstrator in her own kitchen or tries to sell it. When she had a garage sale, she sold a number of unused demonstrators.

Constance includes her demonstrators, including those for discontinued products, in her inventory of goods for sale. When she sells a demonstrator, including those she sold at the garage sale, she includes the income in her gross business receipts.

When Constance starts using a demonstrator in her own kitchen, it is a withdrawal of inventory for personal use. She subtracts the cost of the item from her purchases for the year.

Example #2: Lydia sells needlework kits at sales parties. She has catalogs and a number of kits to show customers. She uses these kits to demonstrate various needlework techniques. The demonstrator kits last less than one year and are not sold to customers. Some are ruined and thrown away. Their cost is treated as a business expense and not inventory.

More than one year of use. If a direct seller uses a demonstrator for more than one year, its cost is a capital expense. However, if the direct seller expects to eventually sell the demonstrator, it is treated as inventory.

Example #1: Mike sells educational books door-to-door. He carries copies of the books to show potential customers. If someone wants a book, he takes a deposit and delivers the book at a later time. His product line changes little from year to year, so Mike can use a book as a demonstrator for a long time. Although he periodically replaces his demonstrators with new ones and sells the old ones at a discount, he has kept some books as demonstrators for up to three years. Because Mike eventually sells his demonstrators, they are part of his inventory of goods for sale.

Example #2: Janet sells the same line of educational books as Mike in Example #1. She tries to use her demonstrators as long as possible. She puts the books in plastic jackets to protect them, and ordinarily only stops using them as demonstrators when the company comes out with a new edition. Janet never sells the old demonstrators. She can recover the cost of the books she uses as demonstrators by depreciating them, or, if eligible, by claiming as a Section 179 expense.

OTHER INCOME

In most cases, business income will be in the form of cash, checks and credit card charges. But business income can be in other forms, such as property or services.

Commissions, Bonuses and Percentages

Many direct sellers receive a commission on their sales or purchases. That commission might be called a bonus or percentage, and it might be based on both the direct seller's own sales and the sales of down-line sellers, or on purchases from the company with which the direct seller is affiliated. The full amount of any commissions received must be reported as income, even if part of the commission is paid to other direct sellers working under the taxpayer. The taxpayer can usually deduct the part paid to others as a business expense.

Prizes, Awards and Gifts

Prizes, awards or gifts received in an individual's role as a direct seller are reported at their FMV as business income. FMV is the price agreed on between a willing buyer and a willing seller when both have reasonable knowledge of the facts and neither is forced

to buy or sell. The following are examples of items that must be included in income:

- Cash;
- Free merchandise;
- Expense-paid trips;
- Use of a car;
- Jewelry signifying an achievement level as a direct seller;
- Membership in organizations or clubs or
- Tickets to sporting events, shows or concerts.



If direct sellers receive the free use of property through their direct sales performance, they must include the FMV of the use of the property in business income. The FMV is generally the amount the direct seller would have to pay a third party to buy or lease the benefit. However, optional valuation methods, such as the cents-per-mile and annual lease value methods can be used to determine the FMV of the use of an automobile. See Reg. 1.61-21 and IRS Pub. 15-B for details on optional valuation methods for the use of a car.

Installation Services

Installation services provided in conjunction with a direct sale are considered direct seller income only if the value of the installation services is 10% or less of the total price, including installation. [Prop. Reg. 31.3508-1(c)(2)(ii)]

Example: Timothy is a direct seller of satellite dishes. His customers pay \$1,000 for the dishes and an additional \$100 if they want the dish installed. Since the cost of the installation service is only 9% of the total cost [\$100 ÷ (\$1,000 + \$100)], the installation service fee is included as part of his income from direct selling.

If the cost of the installation services exceeds 10% of the total price, the taxpayer will need to determine if he will be treated as an employee or a self-employed individual for the installation services based on common-law principals. [Prop. Reg. 31.3508-1(j)]

HOME MEETINGS

Direct sellers who hold business meetings in their homes can deduct expenses for the meetings as entertainment expenses and expenses related to the business use of their home only when they meet certain tests.

The expenses of entertaining business associates in the direct seller's home are deductible as entertainment expenses if they meet the rules discussed under *Meals and Entertainment* on Page 3-19. The expenses of maintaining the direct seller's home as a place of business are deductible if he meets the tests discussed under *Business Use of the Home* on Page 3-19.



Example: Barbara and Bill hold bi-weekly meetings in their home for the direct sellers who work under them. They discuss selling techniques, solve business problems and listen to presentations by company representatives. Because the meetings are for business, Barbara and Bill can deduct 50% of the cost of the food and beverages they provide. (See *Deduction Limit* on Page 3-20.) They keep a copy of their grocery receipts for these refreshments, and record the date, time and business nature of each meeting. Because the meetings are held in their living room rather than in a special area set aside only for business, they cannot deduct any of their home expenses for the meetings.

BUSINESS USE OF THE HOME

Many direct sellers work out of their homes and have business expenses for using their homes. They can deduct expenses for using their home if they meet the following tests: [IRC Sec. 280A(c)(1)]

- 1) The business part of the home is used exclusively and regularly in the taxpayer's business and
- 2) The business part of the home is one of the following:
 - a) The taxpayer's principal place of business,
 - b) A place where the taxpayer meets or deals with clients or customers in the normal course of his trade or business or
 - c) A separate structure (not attached to the home) used in connection with the taxpayer's trade or business.



Caution: Even if direct sellers meet these tests, their deductions may be limited. (See *Deduction Limit* in the next column.)

Exclusive Use

Exclusive use means a specific part of the home is used solely for carrying on the direct selling business. This test is not met if the taxpayer uses the area in question for both the direct selling business and personal purposes. [Prop. Reg. 1.280A-2(g)]

Example: Walter uses a den in his home to write orders and do the paperwork for his business. The den also is used by his children to do their homework. Walter cannot claim any business deduction for the use of the room.

Exception for storing inventory. If part of the home is used to store inventory or product samples, expenses for the business use of the home can be deducted without meeting the exclusive use test if all of the following tests are met: [IRC Sec. 280A(c)(2)]

- 1) The taxpayer keeps the inventory or product samples in his home for use in a direct selling business.
- 2) The home is the only fixed location of the taxpayer's business.
- 3) The storage space is used on a regular basis.
- 4) The space used is separately identifiable and suitable for storage.

Example: Keith's home is the only fixed location of his business. He regularly uses half of his basement for storing inventory as well as for personal purposes. He can deduct the expenses for the storage space even though that part of his basement is not used exclusively for business.

Regular Use

Regular use means that a specific part of the home is used for business on a continuing basis. Occasional or incidental business use of part of the home does not meet the regular use test even if that space is not used for any other purpose.

Principal Place of Business

A home office will qualify as a principal place of business if both the following requirements are met: [IRC Sec. 280A(c)]

- 1) It is used exclusively and regularly for the administrative or management activities of the taxpayer's trade or business.
- 2) There is no other fixed location where the taxpayer conducts substantial administrative or management activities of the trade or business.

Alternatively, if the taxpayer does business at more than one location and the home office does not qualify as the principal place of business based on these rules, the principal place of



Direct Sellers

business is determined based on the following factors: [Prop. Reg. 1.280A-2(b)]

- 1) The portion of the total income from business activities which is attributable to activities at each location,
- 2) The amount of time spent in business activities in each location and
- 3) The facilities available to the taxpayer at each location.

Place to Meet Clients or Customers

If direct sellers meet with clients or customers in their home in the normal course of their direct selling business, even though they also carry on business at another location, they can deduct expenses for the part of their home used exclusively and regularly for business if both of the following apply: [Prop. Reg. 1.280A-2(c)]

- 1) They physically meet with clients or customers on the premises.
- 2) The use of their home is substantial and integral to the conduct of their business.

Direct sellers do not qualify to deduct expenses for the business use of their home under this rule if they have only occasional meetings or telephone calls.



Separate Structure

Direct sellers can deduct the expenses for a separate free-standing structure, such as a studio, garage or barn, if it is used exclusively and regularly for business. This structure does not have to be the principal place of business or a place where the direct seller meets clients or customers.

Deduction Limit

If the direct seller meets the above tests and gross income from the business use of a home equals or exceeds total business expenses (including depreciation), all business expenses related to the use of the direct seller's home are deductible. If gross income from the business use of a home is less than the total business expenses, the deduction for costs other than mortgage interest and property taxes are limited to the net income from the business activity [IRC Sec. 280A(c)(5)]. If there is more than one place of business, only gross income from the business use of the home is counted when figuring the limitation. The business portion of mortgage interest and real estate taxes (if they are otherwise deductible) can create a net loss on Schedule C. Deductions that are disallowed are carried forward to the following year.

Note: A simplified method is also available to compute the deduction for business use of the home. See *Computing the Deduction Using the Safe Harbor Option* on Page 2-19. See IRS Pub. 587 and Tab 6 of the *1040 Quickfinder® Handbook* for details.

MEALS AND ENTERTAINMENT

Certain conditions must be met before a deduction for business meals and entertainment can be claimed.

A deduction for meals includes amounts spent on food and beverages and the taxes and tips on those amounts. Generally, no deduction is allowed for an entertainment-related meal unless the taxpayer (or his employee) is present when the food or beverages are provided to a customer or client.

Include as entertainment any activity generally considered to provide entertainment, amusement or recreation, such as entertaining guests at nightclubs; at social, athletic and sporting clubs; at theaters; at sporting events; on yachts; and on hunting, fishing and vacation trips, or on similar outings. It can also include meeting a customer's personal, living or family needs, such as providing meals, a hotel suite or a car.

Directly Related or Associated Test

To be deductible, the direct seller generally must be able to show that entertainment expenses (including expenses for entertainment-related meals) are directly related to or associated with the active conduct of his business.

Directly related. For entertainment expenses to meet the directly-related test, all of the following must apply: [Reg. 1.274-2(c)(3)]

- 1) The taxpayer had more than a general expectation of getting income or some other specific business benefit from the expense.
- 2) The taxpayer engaged in business with the person during the entertainment period.
- 3) The main purpose of the combined business and entertainment was the active conduct of business.

❖ **Observation:** The taxpayer does not have to show that business income or another business benefit actually resulted from each entertainment expense.

It is not necessary to devote more time to business than to the entertainment. However, if the business discussion is only incidental to the entertainment, it does not qualify as directly related.

Example: Deborah is a direct seller of women's cosmetics. A state women's organization holds its annual convention in a local hotel, and she decides to display her products in a hospitality room in the hotel. Deborah also provides entertainment and gives out product samples. She can deduct the cost of the hospitality room and entertainment provided.

Not directly related. Generally, expenses are not directly related if the taxpayer is not present, or there are substantial distractions that prevent the active conduct of business. The following are situations where there are substantial distractions:

- A meeting or discussion at a nightclub, theater or sporting event.
- A meeting or discussion during what is essentially a social gathering, such as a cocktail party.
- A meeting with a group that includes persons who are not business associates at places such as cocktail lounges, country clubs, golf clubs, athletic clubs or vacation resorts.

Taxpayers may prove the entertainment is directly related to business by clearly establishing they had a substantial business discussion during the entertainment.

When entertainment takes place on a hunting or fishing trip, or on a yacht or pleasure boat, the conduct of business is not considered the main reason for the combined business and entertainment unless the taxpayer clearly shows otherwise.

Associated. Entertainment expenses (including expenses for entertainment-related meals) that do not meet the directly-related test are still deductible if both the following apply: [Reg. 1.274-2(d)]

- 1) The expenses are associated with the direct-selling business.
- 2) The entertainment is directly before or after a substantial business discussion.

An entertainment expense is generally associated with the direct-selling business if the taxpayer can show a clear business purpose for the expense. The purpose may be to get new business or to encourage the continuation of an existing business relationship.

Substantial business discussion. Whether a business discussion is substantial depends upon the facts and circumstances in each case. Taxpayers must show that they actively engaged in a discussion, meeting, negotiation or other business transaction to get income for their business or another specific business benefit.

The meeting does not have to be for a specified length of time. However, the business discussion must be substantial in relation to the entertainment. It is not necessary to devote more time to



business than to the entertainment, and it is not necessary to discuss business during the meal or entertainment.

Expenses for spouses. Taxpayers generally cannot deduct the cost of entertainment for their spouses or for the spouse of a business customer. However, they can deduct these costs if they can show that they had a clear business purpose, rather than a personal or social purpose, for providing the entertainment.

Example: Bill entertains a business customer. The cost is deductible under the entertainment rules. The customer's spouse joins them because it is impractical to entertain the customer without the spouse. Bill can deduct the cost of entertaining the customer's spouse. Furthermore, if Bill's spouse joins the party because the customer's spouse is present, the cost of the entertainment for Bill's spouse also is deductible.

Lavish or extravagant expenses. No deduction is allowed for meals and entertainment to the extent they are lavish or extravagant [IRC Sec. 274(k)]. An expense is not considered lavish or extravagant if it is reasonable considering the facts and circumstances. Expenses will not be disallowed merely because they are more than a fixed dollar amount or take place at a deluxe restaurant, hotel, nightclub or resort.

Deduction Limit

Generally, only 50% of a taxpayer's business-related meal and entertainment expenses are deductible [IRC Sec. 274(n)]. However, the cost of transportation to and from an otherwise allowable business meal or entertainment activity is not subject to the 50% limit. The 50% limit is applied after figuring the amount that would otherwise qualify for a deduction.

Example: Betty spends \$100 for a business-related meal. If \$40 of that amount is not allowable because it is lavish and extravagant, the remaining \$60 is subject to the 50% limit. She cannot deduct more than \$30 (50% × \$60).

TRANSPORTATION

Direct sellers often incur transportation expenses, such as the costs of getting from one workplace to another when traveling within the city or general area that is their tax home, and of getting from their home to a temporary work location.

Transportation expenses also include the following kinds of trips made in the area where the taxpayer lives and works:



- 1) Visiting clients or customers.
- 2) Attending business meetings away from the workplace.

Transportation expenses include train, bus and cab fares, car rental fees and the cost of driving and maintaining a car for business transportation. Meals and lodging are not included in transportation expenses.

Commuting expenses. The cost of transportation between the taxpayer's home and main or regular workplace are nondeductible commuting expenses. These expenses are nondeductible regardless of the distance or whether work is performed during the trip.

Example: Elaine works full time as a bank teller. She also sells cosmetics part-time to her co-workers at the bank. After her customers select items from a catalog, she sends the orders to the cosmetics company. She delivers the items to the bank when she receives them from the company. Elaine's expense of delivering items is not deductible. Her cost of getting to the bank is a commuting expense. The fact that she carries cosmetics does not make her commuting expense a deductible business expense.

Two places of work. Taxpayers who work at two places in one day can deduct the expense of getting from one workplace to the

other. However, if they do not go directly from one location to the other, only the amount it would have cost to go directly from the first location to the second is deductible.

BUSINESS GIFTS

Giving prizes, awards and gifts may be an ordinary and necessary part of doing business as a direct seller. In each of the following situations, they can deduct the cost as a business expense:

Example #1: Deborah does her direct selling on the sales party plan. As an incentive for people to host parties, she offers them a variety of gifts. The choice of gift depends on the success of the party—the higher the volume of sales, the more valuable the gift. In this situation, Deborah's gift to the host or hostess is actually payment for hosting the party, and the host or hostess must report the FMV of the gift as income.

Deborah can deduct the cost of the gift. If she gives hosts and hostesses items from her inventory or items she purchased from the company at the same time she purchases goods to sell, their cost will be included in the cost of goods sold. She cannot deduct their cost again as a business expense. However, if she purchases the gifts separately from the goods she sells, she deducts their cost as an ordinary and necessary business expense.

Example #2: Jim has several direct sellers working under him. Because his income depends in part on their sales, he regularly meets with them, encourages them and provides them with incentives and support. As an incentive to make sales, he sometimes offers a prize, such as an evening on the town or tickets to a sporting event, to the person who sells the most during the month. In this situation, the prizes Jim gives are actually payments for the winners' selling efforts. He can deduct the cost of the prizes as ordinary and necessary business expenses. The direct sellers who receive the incentive prizes must report them as income at their FMV.

Example #3. Angela sells cosmetics door-to-door. To spur sales, she often gives away small samples. In this situation, she can deduct the cost of the samples. If she purchases the samples separately from the products she sells, she can deduct their cost as an ordinary and necessary business expense. However, if the samples were included in inventory, she cannot deduct them as a business expense because the items will already be expensed as part of the cost of goods sold.

Deduction Limit for Gifts

Generally, taxpayers cannot deduct more than \$25 for business gifts given directly or indirectly to any one person during the year (see the exceptions discussed in the next column). A gift for this purpose is a gift that is not included in the recipient's income. [IRC Sec. 274(b)(1)]

☞ **Observation:** Gifts that are actually payment for hosting a party or for achieving a certain level of sales (see *Examples #1* and *#2* under *Business Gifts* above) are included in the recipient's income. Therefore, the \$25 limitation does not apply to the direct seller's deduction. The remainder of this section discusses gifts that are not included in the recipient's income under IRC Sec. 102.

A gift to the spouse (or family member) of a customer is generally considered an indirect gift to the customer. However, if the direct seller has bona fide independent business connections with the spouse (or family member) and the gift is not intended for the customer's eventual use, this rule does not apply.

If the direct seller and his spouse both give gifts, they are treated as one taxpayer for the \$25 limit. It does not matter whether they have separate businesses or independent connections with the recipient.

Incidental cost. Costs that do not add substantial value to a gift, such as engraving on jewelry, packaging, insuring and mailing, are

generally not included in determining the cost of a gift for purposes of the \$25 limit. For example, the cost of gift wrapping is considered an incidental cost. However, the purchase of an ornamental basket for packaging fruit is not considered an incidental cost if the basket's value is substantial in relation to the value of the fruit.

Exceptions: The following items are *not* included in the \$25 limit for business gifts:

- 1) Items that cost \$4 or less, on which the taxpayer's business name is clearly and permanently imprinted, and which are part of a number of identical items he widely distributes. This includes such items as pens, desk sets and plastic bags and cases.
- 2) Signs, display racks or other promotional material to be used on the business premises of the recipient.



Gift or Entertainment

Any item that might be considered either a gift or entertainment will generally be considered entertainment subject to the 50% limit and not subject to the \$25 limit. However, packaged food or beverages to be used later are considered gifts.

If taxpayers provide business associates with tickets to a theater performance or a sporting event and do not accompany them, they may treat the tickets as either a gift or entertainment, whichever is to their advantage. However, if the taxpayer goes to the event with them, the cost of the tickets must be treated as an entertainment expense.

START-UP EXPENSES

The costs of getting started in a business, before the direct seller is authorized to start selling products, are called start-up expenses. Start-up expenses include the cost of exploring different direct-selling opportunities; the cost of any training the direct seller must have before becoming a direct seller for their product line; any fees that must be paid to the company to become a direct seller, and similar costs.

Start-up expenses in direct selling companies include the cost of a starter kit purchased directly from the company. The starter kit may include optional products that are part of the sales display; conceivably, the products could be sold to a customer.

☞ **Observation:** While the portion of the cost of the start-up kit that is attributable to products that could be sold to customers should arguably be treated as inventory, as a practical matter, it may be difficult to determine how much of the kit's cost should be allocated to the products. The cost of the start-up kit is typically not high, so that it is likely the entire cost will be recovered the year incurred if the taxpayer elects under IRC Sec. 195 to deduct start-up costs.

For start-up costs, a taxpayer deducts an amount equal to the lesser of: (IRC Sec. 195)

- 1) The amount of start-up expenditures or
- 2) \$5,000, reduced by the amount by which the start-up expenditures exceed \$50,000.

Any remaining start-up expenditures are deducted ratably over the 180-month period beginning with the month in which the active trade or business begins.

Taxpayers are deemed to elect to deduct (and, if applicable, amortize) start-up costs in the year the business begins. No election statement is required. Instead, deduct/amortize costs in the initial tax year filing. [Reg. 1.195-1]

Electing to capitalize expenditures. Taxpayers who don't want to deduct/amortize their start-up costs must attach a statement to a timely filed (including extensions) return for the year the busi-



ness begins, stating that they elect to capitalize such costs. If the taxpayer elects to capitalize costs, no deduction or amortization is allowed. As a result, the costs will generally not be recovered until the business is sold.

Caution: The elections to either deduct/amortize or capitalize start-up costs are irrevocable and apply to all start-up costs related to the trade or business. Changing an item's classification as a start-up cost is an accounting method change if the taxpayer treated the item consistently for at least two years. A change in the determination of the year in which the business began is also an accounting method change if the taxpayer amortized start-up costs for two or more tax years.

NOT-FOR-PROFIT LIMIT

Because many direct sellers often have other jobs, the IRS may question whether the direct-selling activity is carried on to make a profit. If not, the so-called hobby loss rules limit the deductions that can be claimed for the activity. If the hobby loss limits apply, any loss from direct selling cannot be used to offset any other income.

This limit applies, for example, if individuals go into direct selling primarily for the business deductions they can take. It also applies if they become direct sellers only so they and their friends can buy products at reduced rates.



If the hobby loss limit applies, any allowable deductions can be claimed only if the taxpayer itemizes them on Schedule A (Form 1040). The deductions cannot be claimed on a business tax return, such as Schedule C (Form 1040).

Planning Tip: Any activity, including direct selling, is presumed to be carried on for profit if it produces a profit in at least three of the last five tax years, including the current year, unless the IRS establishes otherwise [IRC Sec. 183(d)]. Direct sellers can elect to postpone an IRS determination as to whether the presumption under IRC Sec. 183(d) applies. This election can be especially useful for taxpayers who are audited in the first or second year after start-up.

The election is made by filing Form 5213, *Election to Postpone Determination*. When the election is made, the IRS will generally postpone its determination of whether the activity is engaged in for profit and will not restrict deductions during the five-year period. The Form 5213 must be filed within three years after the due date of the return for the activity's first year or, if earlier, within 60 days after the IRS issues a written notice proposing to disallow deductions attributable to the activity.

Filing the form automatically extends the period of limitations for tax assessment on any year in the five-year period until two years after the due date (without extension) of the return for the last year of the period. The period is extended only for deductions attributable to the activity and any deductions that are affected by changes made to adjusted gross income.

If taxpayers do not meet the three in five year test, or the IRS challenges their profit motive, they will have to demonstrate, based on the facts and circumstances, that they do have a profit motive. Reg. 1.183-2 provides nine factors to be used in determining whether a taxpayer is conducting an activity with the intent to make a profit. See *Factors Establishing a Profit Motive—Direct Selling* on Page 3-23.

Profit motive factors. No single factor controls, some are more important than others in given circumstances, and other factors may be considered. The mere fact that the number of factors indicating the lack of a profit objective exceeds the number indicating the presence of a profit objective (or vice versa) is not conclusive.

With respect to direct sellers, the following factors are generally the most important for determining whether a profit motive exists:

- **Factor 1** (Manner in Which the Taxpayer Carries on the Activity),
- **Factor 3** (Time and Effort Expended by the Taxpayer),
- **Factor 6** (Taxpayer's History of Income or Losses) and
- **Factor 8** (Extent to Which Taxpayer Depends on Income From Direct Selling for His Livelihood).



Factor 2 (Expertise of the Taxpayer or His Advisors), Factor 5 (Taxpayer's Success in Other Activities) and Factor 9 (Elements of Personal Pleasure or Recreation) are less important. Factor 4 (Expectation That Assets Will Appreciate in Value) rarely will come into play.

Factor 7 (Amount of Occasional Profits, If Any) deserves special note and applies in all situations.

Court Case: A taxpayer's direct selling activity was a hobby, rather than a trade or business. Taxpayer reported a loss from the activity for three years in question. Although she did maintain business records, she did not use them to analyze the business, for example to attempt to reduce her losses or to determine which sales techniques were most successful. The court also noted that she had worked for five direct marketing companies during a three-year period, indicating that she did not perform any analysis of how or why the new company would help her stop losing money. (Smith, William C., TC Memo 2007-154)

INVOLVEMENT OF THE DIRECT SELLER'S SPOUSE

The majority of direct sellers are sole proprietors who file a Form 1040 Schedule C. However, if married individuals are both involved in a business, a partnership may exist. Whether a partnership exists for tax purposes depends on the parties' intent, which is determined by looking at all the facts and circumstances of the business relationship (but see special rules under *Community Property States* on Page 3-24).

Generally, a partnership exists if a married couple jointly own and operate a business. In the direct selling business, one spouse often signs up as the company's representative and the other spouse helps out with the selling, bookkeeping, other duties and activities. In many instances, the spouse that is not the registered representative is not compensated for services rendered. Even so, a partnership may exist for tax purposes.



Partnerships generally file a Form 1065, *U.S. Return of Partnership Income*. Each partner's distributive share of the partnership's income, gains, losses, deductions and credits is reported on the Schedule K-1 for the Form 1065 and must be included on the partner's tax return, even if the items being reported were not distributed.

Unless the direct seller is a limited partner, the distributive share of income from a partnership is self-employment income. If a married couple are partners, they each should report their share of partnership income or loss on a separate Schedule SE (Form 1040), *Self-Employment Tax*. Reporting the partnership income on separate Schedules SE will give each spouse credit for Social Security earnings, on which retirement benefits are based.

Continued on Page 3-24

Factors Establishing a Profit Motive—Direct Selling

Factor	Indications that activity is a business	Comments
1) Manner in Which the Taxpayer Carries on the Activity	<ul style="list-style-type: none"> • Direct seller maintains complete and accurate books and records, including log tracking business miles and customer/party files. • Direct seller maintains a separate business checking account. • Direct seller prepares formal budgets, profit projections or break-even analyses that enable him to determine whether business methods are profitable, and what changes should or can be made to brighten the picture, at least on a quarterly basis. • Form 1099-MISC is filed when required. 	Continued expenditures in activities that show little or no profit potential would be an indication that the activity is not carried on in a businesslike manner.
2) Expertise of the Taxpayer or His Advisors	<ul style="list-style-type: none"> • Seeking the advice of persons who might be considered experts in their business activities. • Regularly attending events that the direct seller believes will provide the expertise necessary to make distributorship profitable. • Consults leaders in their business for business-building information. 	Lack of prior sales training or expertise in direct selling does not negate a profit objective if the direct seller demonstrates willingness to learn the business and gain hands-on experience.
3) Time and Effort Expended by the Taxpayer	<ul style="list-style-type: none"> • The use of the direct seller's time clearly reflects efficiency and growth in the business. He does not work at the activity haphazardly. • Direct seller spends time evaluating whether particular activities show profit potential and attempting to determine whether to continue them. • Direct seller displays a desire to recruit down-liners. • Direct seller increases the number of sales or opportunity presentations as time goes by. • Direct sellers seek out opportunities to make themselves more visible in the public eye. • Direct seller changes methods of operation in an attempt to improve profitability. 	How time is spent is more important than the amount of time spent on the activity. Spending time on activities that indicate that the direct seller is trying to grow a business indicates that the activity is not merely a hobby.
4) Expectation That Assets Will Appreciate in Value	Typically not applicable to direct sellers.	The fact that most direct sellers typically have few business assets should not cause one to question the legitimacy or viability of the business.
5) Taxpayer's Success in Other Activities	Direct seller has engaged in similar activities in the past and converted them from unprofitable to profitable enterprises (even if the present activity is not currently profitable).	The fact that the taxpayer has not been engaged in a similar activity in the past does not negate a profit motive in the present activity. However, if the taxpayer has unsuccessfully engaged in similar activities in the past, he may not have a profit motive.
6) Taxpayer's History of Income or Losses	<ul style="list-style-type: none"> • Taxpayer has experienced a series of profitable years. • Taxpayer can provide evidence that the business will eventually become profitable. 	A series of losses incurred during the startup stage of an activity does not necessarily indicate the lack of a profit objective, but it may so indicate if the losses continue beyond the customary startup period and are not otherwise explainable as due to customary business risks.
7) Amount of Occasional Profit, If Any	Substantial profit, though only occasional, would generally be indicative that an activity is engaged in for profit, where the investment or losses are comparatively small.	An occasional small profit from an activity generating large losses, or from an activity in which the taxpayer has made a large investment, would not generally be determinative that the activity is engaged in for profit.
8) Extent to Which Taxpayer Depends on Income from Direct Selling for His Livelihood	Taxpayer does not have any other substantial source of income.	The fact that a taxpayer carries on employment or more than one business at any given time is not evidence of a lack of a profit motive.
9) Elements of Personal Pleasure or Recreation	Expending a substantial amount of time in activities, such as driving long distances that would appear to lack elements of pleasure or recreation.	<ul style="list-style-type: none"> • Profit need not be the only objective, and personal motives may coexist with an actual and honest intent to derive a profit. • Normally, a prudent direct seller organizes various quasi-social environments in which to market its products or connect with "prospects," which often involves family, friends and acquaintances. These business activities should not be discounted on their face if they can be shown to have been appropriate and helpful in developing the business. • The direct seller can enjoy his business and receive personal pleasure from it, but still be engaged in it for profit. It should be considered whether any significant recreational or entertainment element was ordinary and necessary to grow the business.

Source: IRS's Retail Industry Audit Techniques Guide

Ⓢ **Observation:** Certain businesses carried out by a married couple that would otherwise be classified as a partnership can elect not to be taxed as a partnership. The election is available if all the following are true: [IRC Sec. 761(f)]

- 1) The only parties carrying out the business are spouses who file a joint return.
- 2) Both spouses materially participate (as defined under the Section 469 passive activity loss rules) in the business.
- 3) Both spouses elect out of partnership taxation.
- 4) The business is not operated as a limited liability company.

If this election is made, the spouses are treated as if they each conducted their share of the business as a sole proprietor. They report their respective shares of income or loss on their own Schedule C. Likewise, each spouse recognizes his respective share of SE income from the business.

📌 **Practice Tip:** If the SE income is allocated between the two spouses (rather than all reported by one of them) the couple's SE tax liability may be increased because SE income under \$118,500 (for 2016) is taxed at 15.3%, while income over that amount is only taxed at 2.9%. Reporting all of the earnings on just one of the spouse's Schedule SE may result in some of those earnings being taxed at the lower rate, while dividing them between two individuals may mean that all SE earnings are taxed at the 15.3% rate.

Ⓢ **Observation:** SE income may also be subject to the 0.9% additional Medicare tax (reported on Form 8959) on earned income if the combined earned income of the spouses exceeds \$250,000.



Example: In 2016, Tom's income subject to SE tax is \$140,000. Tom's wife Faye is involved in his direct selling business, but Tom has always filed his tax returns showing all the income on his Schedule C, along with a single Schedule SE for himself. The IRS examines their return and determines that Faye is actually Tom's partner. Thus, each of them will report half of the SE earnings on their own Schedule SE. The effect of this adjustment is as follows:

	All Income Reported by Tom	Half Reported by Tom	Half Reported by Faye
Income up to \$118,500	\$ 118,500	\$ 70,000	\$ 70,000
Tax at 15.3% (A)	\$ 18,130	\$ 10,710	\$ 10,710
Income over \$118,500	\$ 21,500	\$ 0	\$ 0
Tax at 2.9% (B)	\$ 624	\$ 0	\$ 0
Total Tax (A + B)	\$ 18,754	\$ 10,710	\$ 10,710

The total SE tax under the IRS income allocation is \$21,420 (\$10,710 × 2). This is \$2,666 (\$21,420 – \$18,754) more than if Tom reports all the SE income.

Formalizing the arrangement between the spouses can help prevent the IRS from successfully arguing that the business is a partnership and splitting the income between the spouses. For example, the less-involved spouse could sign an employment agreement as an employee of the more-involved spouse's business. It may also be advisable to ensure that the more-involved spouse is solely responsible for major business decisions.



Community Property States

If the spouses live in a community property state and any income derived from a trade or business is community income (under that state's community property laws), the SE income (or loss) from that business is treated as income of the spouse carrying on business. If only one spouse participates in the business, all of the income from

that business is treated as that spouse's SE earnings. If both spouses operate the business, the SE income is allocated based on each spouse's participation in the business [IRC Sec. 1402(a)(5)(A)]. If the business is operated as a partnership, each partner reports his distributive share of income as SE income.

Determining whether a partnership exists is different for taxpayers in community property states than in separate property states. In community property states, the IRS will respect whichever treatment (sole proprietorship or partnership) the taxpayers use (as indicated by how they file their tax return) (Rev. Proc. 2002-69). Thus, the taxpayers can select the treatment they prefer. In separate property states, this determination is based on the facts and circumstances.

However, as is the case in separate property states, these rules for reporting trade or business income either as a partnership between the spouses or as a proprietorship do not apply if one spouse is a genuine employee of the other spouse's sole proprietorship.

REPORTING REQUIREMENTS

Form 1099

1099s issued. Direct sellers must file an information return if they make direct sales of at least \$5,000 of consumer products to a buyer for resale anywhere other than a permanent retail establishment. The information return, Form 1099-MISC, must show the name, address, and identification number of the buyer (recipient). Check box 9 of Form 1099-MISC to show these sales. Do not enter a dollar amount.

The direct seller must also provide a statement to the buyer by January 31 of the year following the calendar year for which the information return is filed, showing his name, address, phone number and identifying number. The statement given to the buyer for these direct sales may be in the form of a letter showing this information along with commissions, prizes, awards, etc.



📌 **Note:** A Form 1099-MISC must also be issued to any noncorporate service providers to whom the direct seller pays \$600 or more during the year.

1099s received. Direct sellers who purchase at least \$5,000 of consumer products for resale during the year will receive a Form 1099-MISC from the person who sold them the goods (often the company whose products they sell). They may also receive Form 1099-MISC if they are the recipients of commissions, prizes, awards, etc.

Direct sellers may also receive Form 1099-K if they use a payment settlement entity (PSE) to process credit card sales. The Form 1099-K will include the gross amount of the payment, including sales tax. The direct seller will need to maintain good records to determine what amounts may reduce gross sales. See *Form 1099-K Reporting* on Page 9-19 for additional information.

Schedule C

Unless the business is a partnership, income and expenses from direct selling are reported on Schedule C. The *Tax Organizer—Direct Sellers* on Page 3-25 can be used to gather the pertinent information.

When filing Schedule C, the direct seller should input a six-digit NAICS code. While there are several codes that relate to nonstore retailers, NAICS #454390 is generally the most appropriate code for direct selling businesses.

Tax Organizer—Direct Sellers

Name: _____ Tax Year: _____

Principal Business/Product Sold: _____

Business Name and Address (if different than residence): _____

Date Business Started (if started this year): _____

Did you pay any individuals or other noncorporate service providers \$600 or more during the year? _____

Did you make direct sales of at least \$5,000 of consumer products to a buyer for resale anywhere other than a permanent retail establishment? _____

Part 1—Inventory (at your cost)	
Inventory at Beginning of the Year (Should match "Cost of Inventory for Sale at Year-End" from last year's organizer)	
Total Purchases During the Year	
Purchase Returns and Allowances	
Cost of Items Taken for Personal Use—DO NOT INCLUDE BUSINESS GIFTS	
Cost of Inventory for Sale at Year-End	

Part 2—Income (attach any Form 1099s received)	
Total Retail Sales	
Commissions Received	
Prizes Won	
Other Income (attach detail) _____	

Part 3—Deductions	
Advertising (posters, Yellow Pages, booth rental, retail display products, etc.) ¹	
Bad Debts (uncollectable debts if the related sale is included in "Total Retail Sales," above)	
Bank Service Charges	
Classes, Workshops and Seminars	
Commissions Paid	
Demonstrators (not for sale)	
Hostess Gifts, Flowers	
Interest on Business Loans	
Magazines, Books, Tapes, Educational Aids	
Meals and Entertainment	
Meeting Room Rent	
Membership Fees	
Office Supplies	
Other Gifts (list recipients and amounts) ¹	
Postage	
Prizes Given to Customers and other Direct Sellers ¹	
Product Replacement Insurance	
Professional Fees (legal, tax preparation, accounting, etc.)	
Salaries	
Sales Aids From the Direct Selling Company	
Start-Up Kit (if started this year)	
Telephone (long distance for business, cost of separate line used only for business, cell phone, etc.)	
Travel for Business Trips (Airfare, Rent Car, Hotel, Meals, Cabs, Tips, Laundry, etc.)	
Other Expenses (attach detail)	

¹ Only include cost of products if their cost is not included in "Purchases" in Part 1.

Part 4—Vehicle Information	
Vehicle Description:	
Odometer Reading at End of Year	
Odometer Reading at Beginning of Year	
Total Miles Driven for the Year	
Total Miles Driven for Direct Selling Business	

Part 5—Car Expenses (actual costs for the year)	
Gas	
Insurance	
Repairs and Maintenance	
Lease Payments	
Parking and Tolls (Business-related only)	
Other: _____	

Part 6—Home Office Expenses (must meet certain tests to deduct)	
Mortgage Interest	
Property Taxes	
Utilities (not listed in Part 3)	
Repairs and Maintenance	
Homeowner's Insurance:	
Other: _____	
Other: _____	

Part 7—Business Assets Purchased During the Year (such as car, computer, desk, answering machine, etc.)			
Description	Date Acquired	Cost	% Used for Business Purposes

Part 8—Other Information	