CLIENT REPORT:

Fact Sheet on the Tax Gap for Direct Sellers

Dear Client:

The IRS has released a fact sheet that provides guidance to direct sellers (DSs) on reporting income, properly claiming deductions, and inventory recordkeeping. As you probably know, a direct seller's compensation is related to sales rather than to the number of hours worked. Services are performed under a written contract between the direct seller (DS) and the person for whom the DS performs the services, and the contract stipulates that the DS is not treated as an employee for federal tax purposes.

Direct sellers may include persons who:

- sell consumer products in the home or a place of business other than a permanent retail store; or
- sell consumer products on a deposit or commission basis, or to other persons who will sell the products in the home or place of business; or
- deliver and/or distribute newspapers or shopping guides.

A direct seller may need to report as income:

- sales, commissions, or bonuses; or
- the value of prizes, awards, gifts and products received from the selling business; or
- a percentage of the sales of others who work for the DS.

Generally, the DS will receive a Form 1099-MISC from the payer under any contract. However, if this information return is not provided, the direct seller is still required to report all of the income received on their income tax return. Additionally, if consumer products totaling $5,000 or more are sold to a buyer for resale, the DS is required to report the amount of the sale on Form 1099-MISC and check box 9.

Direct sellers can generally deduct ordinary and necessary business expenses, but start-up expenses are not deductible unless the DS makes an election during the year the business begins. For start-up expenses paid after October 22, 2004, a deduction may be taken the year the business begins by an amount equal to the lesser of the amount of start-up expenses, or $5,000 reduced by the amount the start-up expenses exceed $50,000. Any remaining expenses may be deducted over the 180-month period beginning with the month the business begins.

Start-up expenses may include the following costs:

- exploring different direct-selling opportunities;
- training to be a DS for a product line;
- fees paid to the company to become a DS; and
- purchasing a starter kit from the company.

Direct sellers must take a physical inventory of products on hand at the beginning and end of each taxable year in order to correctly reflect income. Products held in inventory may include:

- merchandise with title vested in the DS;
- goods under contract for sale but not yet segregated and applied to the contract; and
- goods out on consignment.

Since you have a direct selling business, we would be happy to answer any further questions you may have regarding income tax issues or recordkeeping requirements. Please call our office at your earliest convenience to arrange an appointment.

Sincerely yours,

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