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Direct Sellers

For use in preparing
2001 Returns



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Contents

Important Change for 2001	1
Important Reminder	1
Introduction	1
Who Is a Direct Seller?	2
Basic Tax Information	2
Business Income	4
Capital Expenses	6
Cost Recovery	7
Business Expenses	7
Business Use of Your Home	9
Travel and Local Transportation	10
Meals and Entertainment	10
Business Gifts	11
Not-for-Profit Limit	12
Recordkeeping	12
How To Get Tax Help	14
Index	15

Important Change for 2001

Standard mileage rate. The standard mileage rate for the cost of operating your car in 2001 is 34½ cents a mile for all business miles.

Important Reminder

Photographs of missing children. The Internal Revenue Service is a proud partner with the National Center for Missing and Exploited Children. Photographs of missing children selected by the Center may appear in this publication on pages that would otherwise be blank. You can help bring these children home by looking at the photographs and calling **1-800-THE-LOST** (1-800-843-5678) if you recognize a child.

Introduction

This publication explains general tax information of interest to direct sellers. It covers how to treat income, expenses, and other items related to having a direct-sales business.

Who is a direct seller? Some of the characteristics that identify direct sellers are listed below. A more complete discussion is contained under the heading *Who Is a Direct Seller*, later.

- **How you sell.** You sell consumer products to others on a person-to-person basis, usually working out of your home. Or, you deliver or distribute newspapers or shopping news.
- **Where you sell.** You may sell door-to-door, through the sales party plan, or by appointment in someone else's home.
- **When you sell.** You may sell on a regular basis or only occasionally. You may sell full-time or part-time, such as a sideline to a regular job.

Who is not a direct seller? You are not a direct seller if you are employed in a store, sell through a retail sales outlet, or sell your employer's product away from the employer's place of business.

Comments and suggestions. We welcome your comments about this publication and your suggestions for future editions.

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You can write to us at the following address:

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We respond to many letters by telephone. Therefore, it would be helpful if you would include your daytime phone number, including the area code, in your correspondence.

Useful Items

You may want to see:

Publication

- 1** Your Rights as a Taxpayer
- 15** Circular E, Employer's Tax Guide
- 15-A** Employer's Supplemental Tax Guide
- 15-B** Employer's Tax Guide to Fringe Benefits
- 334** Tax Guide for Small Business
- 463** Travel, Entertainment, Gift, and Car Expenses
- 505** Tax Withholding and Estimated Tax
- 525** Taxable and Nontaxable Income
- 533** Self-Employment Tax
- 535** Business Expenses
- 538** Accounting Periods and Methods
- 583** Starting a Business and Keeping Records
- 587** Business Use of Your Home
- 946** How To Depreciate Property

Form (and Instructions)

- SS-4** Application for Employer Identification Number
- Sch A (Form 1040)** Itemized Deductions

- Sch C (Form 1040)** Profit or Loss From Business
- Sch C-EZ (Form 1040)** Net Profit From Business
- Sch SE (Form 1040)** Self-Employment Tax
- 1040** U.S. Individual Income Tax Return
- 1040-ES** Estimated Tax for Individuals
- 1099-MISC** Miscellaneous Income
- 2210** Underpayment of Estimated Tax by Individuals, Estates, and Trusts
- 4562** Depreciation and Amortization
- 8829** Expenses for Business Use of Your Home

See *How To Get Tax Help* near the end of this publication for information about getting publications and forms.

Who Is a Direct Seller?

You are a direct seller if you meet **all** the following conditions.

- 1) You are engaged in one of the following trades or businesses.
 - a) Selling or soliciting the sale of consumer products, either —
 - i) In a home or other place that is not a permanent retail establishment, or
 - ii) 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.
 - b) Delivering or distributing newspapers or shopping news (including any services directly related to that trade or business).
- 2) Substantially all your pay (whether paid in cash or not) for services described in (1) is directly related to sales or other output (including the performance of services) rather than to the number of hours worked.
- 3) Your services are performed under a written contract between you and the person for whom you perform the services, and the contract provides that you will not be treated as an employee for federal tax purposes.

As a direct seller, you usually sign up with a particular company to sell its product line. The company may refer to you by one of the following titles.

- Consultant
- Coordinator
- Dealer
- Demonstrator
- Designer
- Director
- Distributor or direct distributor

- Instructor
- Manager or supervisor
- Representative or sales representative

Self-employed. Direct sellers are self-employed. This generally means you have to pay self-employment tax (discussed later under *Business Taxes*).

Employee. You are a direct seller only if you are in business for yourself. Selling consumer products as a company employee does not make you a direct seller.

The fact that you work under another direct seller does not make you that person's employee.

Recruiting. You are engaged in the trade or business of selling or soliciting if you attempt to increase the sales of direct sellers who work under you (your "downline" group) and your earnings depend in part on how much they sell. Recruiting, motivating, and training are examples of attempts to increase sales.

Host or hostess. You are not a direct seller if you simply host a party at which sales are made. Nevertheless, some information in this publication may still apply to you.

The "gift" you receive for giving the party is a payment for helping the direct seller make sales. You must report it as income at its fair market value. See *Other Income*, later.

Your out-of-pocket party expenses are subject to the 50% limit for meal and entertainment expenses, discussed under *Meals and Entertainment*, later. These expenses are deductible as miscellaneous itemized deductions subject to the 2% limit on Schedule A (Form 1040), but only up to the amount of income you receive for giving the party. See *Not-for-Profit Limit*, later.

Basic Tax Information

The following discussion gives basic tax information that may help if you have never been in business for yourself. For more information about starting a business, see Publication 583.

Employer Identification Number (EIN)

EINs are used to identify the tax accounts of employers, certain sole proprietors, corporations, partnerships, estates, trusts, and other entities.

If you do not already have an EIN, you need to get one if any of the following apply to your business.

- 1) You have employees.
- 2) You have a qualified retirement plan.
- 3) You operate your business as a corporation or partnership.
- 4) You file returns for:
 - a) Employment taxes,
 - b) Excise taxes, or
 - c) Taxes on alcohol, tobacco, or firearms.

Use Form SS-4 to apply for an EIN.

Business Taxes

The following kinds of federal business taxes may apply to direct sellers.

- Income tax
- Self-employment tax
- Employment taxes

Your state, county, or city may impose other kinds of tax and licensing obligations.

Income tax. All businesses except partnerships must file an annual income tax return. (Partnerships file an information return.) For example, if you operate your direct-selling business as a sole proprietor, you must file Schedule C or Schedule C-EZ as part of your individual income tax return (Form 1040). You are a sole proprietor if you are self-employed (work for yourself) and are the only owner of your unincorporated business.

Self-employment tax. Self-employment tax is the social security and Medicare tax for those who work for themselves. It is similar to the social security and Medicare taxes withheld from the pay of wage earners. If you are a direct seller, you generally must pay this tax on your income from direct selling. You must pay it whether you are a sole proprietor or a partner in a partnership. Use Schedule SE (Form 1040) to figure your self-employment tax. For more information about self-employment tax, see Publication 533.

Social Security Administration (SSA) time limit for posting self-employment income. Generally, the SSA will give you credit for self-employment income reported on a tax return filed within 3 years, 3 months, and 15 days after the tax year you earned the income. If you file your tax return or report a change in your self-employment income after this time limit, SSA may change its records, but only to remove or reduce the amount. SSA will not change its records to increase the amount of your self-employment income.

Employment taxes. If you have employees in your business, you generally withhold and pay the following kinds of employment taxes.

- The federal income tax you withhold from employees' wages.
- Social security and Medicare taxes—both the amount you withhold from employees' wages and the amount you pay as the employer.
- Federal unemployment (FUTA) tax (none of which is withheld from the employees' wages).

For more information, see Publication 15.

Other taxes. For information about deducting personal property and other taxes, see *Taxes* under *Business Expenses*, later.

Estimated Tax

The federal income tax is a pay-as-you-go tax. You must pay it as you earn or receive income

during the year. There are two ways to pay as you go.

- **Withholding.** If you are an employee, your employer likely withholds income tax from your pay. By revising your W-4, you can increase your withholding to cover the income from your job and from direct selling.
- **Estimated tax.** If you do not pay tax through withholding, or do not have enough withheld, you may have to pay estimated tax.

Estimated tax is used to pay both income and self-employment taxes. For more information on estimated tax, see Publication 505.

Exceptions. You do not have to pay estimated tax if you meet either of the following exceptions.

- You had no tax liability last year, you were a U.S. citizen or resident for the whole year, and your tax year covered all 12 months.
- Your total expected taxes for 2002, minus any expected tax credits and withholding, will be less than \$1,000.

Form 1040-ES. Use Form 1040-ES to figure your estimated tax and make quarterly estimated tax payments.

Form 2210. If you did not pay enough estimated tax or have enough income tax withheld, you may be subject to a penalty for underpayment of tax. You can use Form 2210 to figure the penalty. In most cases, you can have the Internal Revenue Service figure the penalty for you. See the Form 2210 instructions to determine if you must complete the form.

Information Returns

If you have other direct sellers working under you and you sell \$5,000 or more in goods during the year to any one of those sellers, you must report the sales on an information return. The information return, Form 1099-MISC, must show the name, address, and identification number of the seller placing the orders. Check box 9 of Form 1099-MISC to show these sales. Do not enter a dollar amount. You must give Copy B or a qualified statement (such as a letter showing this information along with commissions, prizes, awards, etc.) to the seller by January 31, 2002.

You must file Copy A of Form 1099-MISC with the Internal Revenue Service by February 28, 2002. If you file electronically, you have until April 1, 2002. Use Form 1096 to summarize and transmit Form 1099-MISC. See the instructions for Form 1099-MISC.

Penalties

The law imposes penalties for noncompliance with tax laws. Some of these penalties are discussed next. If you underpay your tax due to fraud, you could be subject to a civil fraud penalty. In certain cases, you could be subject to criminal prosecution.

Failure-to-file penalty. If you do not file your return by the due date (including extensions),

you may have to pay a failure-to-file penalty. The penalty is 5% of the tax not paid by the due date for each month or part of a month that the return is late. This penalty cannot exceed 25% of your tax, and it is reduced by the failure-to-pay penalty (discussed next) for any month both penalties apply. However, if you file your return more than 60 days after the due date or extended due date, the minimum penalty is the lesser of \$100 or 100% of the unpaid tax. You will not have to pay the penalty if you show that you failed to file on time because of reasonable cause and not because of willful neglect.

Failure-to-pay penalty. You may have to pay a penalty of 1/2 of 1% of your unpaid taxes for each month or part of a month after the due date that the tax is not paid. This penalty cannot be more than 25% of your unpaid tax. You will not have to pay the penalty if you can show good reason for not paying the tax on time. This penalty does not apply during the automatic 4-month extension of time to file if you paid at least 90% of your actual tax liability on or before the due date of your return and you pay the balance when you file the return.

The monthly rate of the failure-to-pay penalty is half the usual rate (.25% instead of .50%) if an installment agreement is in effect for that month. You must have filed your return by the due date (including extensions) to qualify for this reduced penalty.

Penalty for frivolous return. You may have to pay a penalty of \$500 if you file a return that does not include enough information to figure the correct tax or that contains information clearly showing the tax you reported is substantially incorrect.

You will have to pay the penalty if you filed this kind of return for either of the following reasons.

- A frivolous position on your part.
- A desire to delay or interfere with the administration of federal income tax laws.

This penalty is in addition to any other penalty provided for by law.

Accuracy-related penalty. An accuracy-related penalty of 20% applies to any underpayment due to the following reasons.

- Negligence or disregard of rules or regulations.
- Substantial understatement of income tax.

This penalty also applies to conditions not discussed here.

Even though an underpayment was due to both negligence and substantial underpayment, the total accuracy-related penalty cannot exceed 20% of the underpayment. The penalty is not imposed if you can show reasonable cause and that you acted in good faith.

Negligence. Negligence includes the lack of any reasonable attempt to comply with provisions of the Internal Revenue Code.

Disregard. Disregard means the careless, reckless, or intentional disregard of rules or regulations.

Substantial understatement of income tax. For an individual, income tax is substantially

understated if the understatement exceeds the greater of the following amounts.

- 10% of the correct tax.
- \$5,000.

Information reporting penalties. A penalty applies if you do not file information returns by the due date, do not include all required information, or do not report correct information. The amount of the penalty is based on when you file the correct information return, as follows.

- Correct information returns filed within 30 days after the due date, \$15 each.
- Correct information returns filed after the 30-day period but by August 1, \$30 each.
- Information returns not filed by August 1, \$50 each.

Maximum limits apply to all these penalties.

Failure to furnish correct payee statements. If you do not provide a complete, correct, and timely copy of an information return (payee statement), you may be subject to a penalty of \$50 for each statement. If the failure is due to intentional disregard of the requirements, the minimum penalty is \$100 per statement with no maximum penalty.

Failure to supply identification number. If you do not include your identification number (SSN or EIN) or the identification number of another person where required on a return, statement, or other document, you may be subject to a penalty of \$50 for *each* failure. You may also be subject to the penalty if you do not give your identification number to another person when it is required on a return, statement, or other document.

You will not have to pay the penalty if you can show the failure was due to reasonable cause and not willful neglect.

Accounting Periods and Methods

All income tax returns are prepared using an accounting period (tax year) and an accounting method.

Accounting Periods

When preparing a statement of income and expenses, you must use books and records for a specific interval of time called an accounting period. The annual accounting period for your tax return is called a **tax year**. You can generally use one of the following tax years.

- **A calendar year**, which begins on January 1 and ends on December 31.
- **A fiscal year** (including a period of 52 or 53 weeks). A regular fiscal year is 12 consecutive months ending on the last day of any month except December.

You establish a tax year when you file your first income tax return. If you filed your first return as a wage earner using the calendar year, you must use the calendar year as your business tax year. You generally cannot change your tax year without IRS approval.

For more information, see Publication 538.

Accounting Methods

An accounting method is a set of rules used to determine when and how income and expenses are reported. You must use the same accounting method from year to year. The two most common accounting methods are the cash method and an accrual method. A third method, called a hybrid method, is generally a combination of cash and accrual.

The text and examples in this publication generally assume you use the calendar year as your tax year and either the cash or hybrid method as your accounting method. Generally, if inventories are needed to account for your income, you must use an accrual method, discussed later, for your sales and purchases. However, if you are a qualifying taxpayer, you can choose to do the following, even if you produce, purchase, or sell merchandise in your business.

- Use the cash method of accounting.
- Not keep an inventory, even if you do not change to the cash method.

For more information, including the definition of a qualifying taxpayer, see *Inventories* in Publication 334.

Cash method. Under the cash method, you report income in the year it is received, credited to your account, or made available to you on demand. You need not have physical possession of it. You deduct expenses in the year you pay them, even if they were incurred in an earlier year.

Check received. If you receive a check before the end of the tax year, you must include it in income for the year you receive it even though you do not cash or deposit it until the next year.

Accrual method. Under an accrual method, you generally report income in the tax year when all events have occurred that fix your right to receive the income and you can determine the amount with reasonable accuracy. Generally, you deduct or capitalize business expenses when you become liable for them, whether or not you pay them in the same year.

Prepaid expenses. Expenses paid in advance can only be deducted in the year to which they apply under either the cash or an accrual method. For example, suppose you have a subscription to a direct-selling journal that runs out at the end of 2001. It will cost you \$30 to renew the subscription for one year or \$54 for 2 years. You decide to renew for 2 years and mail your check at the end of November 2001. You cannot deduct the \$54 on your 2001 return, even if you use the cash method of accounting. However, you can deduct half of the \$54 in 2002 and the other half in 2003.

Business Income

You must report all income you receive as a direct seller. This includes any of the following.

- Income from sales—payments you receive from customers for products they buy from you.
- Commissions, bonuses, or percentages you receive for sales and the sales of others who work under you.
- Prizes, awards, and gifts you receive from your selling business.

You must report this income regardless of whether it is reported to you on an information return.

Income From Sales

You have income from sales if your customers buy directly from you and you buy the products you sell from a company (or another direct seller).

If some of your customers buy their products directly from the company, you, as the sales agent, do not have any sales income from these transactions. You will generally receive a commission or “bonus” for making the sale, but you will have no direct income from the sale itself. If all of your sales are handled this way, the rules in this section do not apply to you. Report your commissions as other business income. For more information, see *Other Income*, later.

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

Example 1. Your customers pay you the retail price for goods they order. You forward the orders and payments to the company. The company sends the merchandise to fill the orders. The company also sends you a commission.

You are acting as a sales agent for the company. You did not purchase the products to sell to your customers. Your payment from the company is commission income, not income from sales. Include the commission in your gross receipts. The amount your customers pay for the goods they order is not included in income.

Example 2. Your customers pay you a deposit when you take their orders. You send the orders to the company, but keep the deposits for yourself. The company fills the orders by shipping the merchandise to your customers. Your customers pay the company the remainder of the retail price (usually cash on delivery).

You are acting as a sales agent for the company. The deposit is your commission income. You have no income from sales.

Example 3. Your customers pay you for the goods you sell them, either when you take their orders or when you make deliveries. After your customers place orders, you order the goods from the company (or from a direct seller you work under). You either send the money directly to the company with your orders, or you are billed later. In either case, you are able to charge your customers more than you pay for the goods.

You are buying products “wholesale” and selling them “retail.” The full amount received from your customers is income from sales.

Example 4. You keep a supply of goods that your customers regularly buy from you. This

allows you to fill their orders without delay. You order and pay for the goods before your customers request them.

You have purchased goods to resell to customers. The full amount received from your customers is income from sales.

Example 5. You have recruited several other direct sellers who order their products through you. Commissions or bonuses paid to you by the company are shared with the direct sellers in your "group" based on sales, purchases, or some other formula established by the company whose products you sell. You keep the portion of the commissions you are not required to distribute to the direct sellers in your group.

The bonuses you receive from the company are included in income as commissions, not as income from sales.

Gross Profit

Gross receipts minus cost of goods sold equals gross profit.

If you have income from sales, figure your gross profit and the income to report by following these steps.

- 1) Figure the total your customers paid you during the year for goods you sold them. Include this in the gross receipts you report on line 1 of Schedule C.
- 2) Subtract the amount (if any) your customers paid that you had to return in the form of refunds, rebates, or other allowances. Show this on line 2 of Schedule C.
- 3) Finally, subtract the cost of the goods sold (line 4 of Schedule C). To figure the cost of goods sold, you must know the value of the inventory at the beginning and end of the year, and your purchases during the year. See *Cost of Goods Sold*, next, and *Inventory*, later.

Cost of Goods Sold

To figure your cost of goods sold, follow these steps.

- 1) Start with the value of your inventory at the beginning of the tax year. This is usually the same as the value of your inventory at the end of the previous year. Valuing inventory is discussed later under *Inventory*.
- 2) Add to your beginning inventory the cost of merchandise you bought during the year to sell to customers. This does not include the cost of merchandise you bought for your own use.
- 3) Subtract from this total the inventory on hand at the end of the year. The difference is your cost of goods sold during the year.

Example 1. Janet sells cookware on the sales-party plan. On December 31, 2000, she did not have any cookware on hand to sell to customers. She does not have a beginning inventory for 2001.

During the year, Janet spent \$5,270 on goods in her product line. Of this amount, \$130

was for cookware sets she gave for personal gifts and \$40 was for a set for her own use. She purchased \$5,100 [\$5,270 - (\$130 + \$40)] worth of goods to sell to customers.

On December 31, 2001, Janet had several sets of cookware in boxes for delivery to customers. The cost of these sets was \$220. Her ending inventory for the year is \$220, and her cost of goods sold for 2001 is \$4,880 (\$0 beginning inventory + \$5,100 purchases - \$220 ending inventory).

Example 2. 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 merchandise costing \$200 on hand at the end of 2000 (which would be her beginning inventory for 2001) and merchandise costing \$175 at the end of 2001. During the year she purchased \$3,250 of merchandise. Purchase returns and allowances were \$50. She withdrew \$200 of cosmetics for personal use. Lisa figures her cost of goods sold for 2001 as follows:

Beginning inventory	\$200
Add: Merchandise purchased during the year	\$3,250
Subtract: Purchase returns and allowances	50
Subtract: Goods withdrawn for personal use	200
Goods available for sale	\$3,200
Subtract: Ending inventory	175
Cost of goods sold	<u>\$3,025</u>

Lisa figures her gross profit by subtracting the cost of goods sold from her gross receipts (\$5,375) for the year as follows:

Gross receipts	\$5,375
Minus: Cost of goods sold	3,025
Gross profit	<u>\$2,350</u>

Purchases. When figuring cost of goods sold, include the **full cost** of all merchandise you buy to sell to customers. This cost includes all postage and freight charges incurred.

Figure your purchases at the actual price you pay. Deduct a **cash discount** or a **trade discount** in figuring the cost of your purchases. A cash discount or a trade discount is the difference between the invoice price and the actual price you have to pay.

Purchase returns and allowances. Subtract purchase returns and allowances from your total purchases for the year when figuring cost of goods sold. This includes any rebates or refunds you received off the purchase price. It also includes any credit you received for returned merchandise.

Personal withdrawals. Subtract from your purchases for the year the cost of goods in your product line that you bought for personal use and the cost of goods you withdrew from inventory. Merchandise is considered withdrawn from inventory when it is no longer available for sale to customers. For example, if you sell a particular kind of soap and give some as a gift or use some yourself, you must withdraw the soap from inventory because it is no longer available for sale. Follow this procedure for all products withdrawn for personal use, even if you are using the product only to familiarize yourself with its characteristics or to demonstrate "loyalty" to the company whose products you sell.

Inventory

Many direct sellers have little or no inventory. Others keep a considerable inventory on hand. For an exception to the inventory requirements, see *Accounting Methods*, earlier.

If you account for inventories, you need to know how to figure your inventory at the end of each tax year. Your inventory practices must be consistent from year to year.

Figuring inventory involves:

- 1) Taking inventory,
- 2) Identifying the cost, and
- 3) Valuing the inventory.

You need to know your inventory at the beginning and end of each tax year to figure your cost of goods sold. Beginning inventory will usually be the same as the prior year's ending inventory. Any differences must be explained in a schedule attached to your return.

Taking inventory. The first step is to identify and count all merchandise in your inventory. Include all goods to which you have title at the end of the year. This will generally be any goods you have on hand and have not yet sold to customers.

Include merchandise you have purchased, even if you have not yet physically received the goods. You may also have title to goods that were shipped to you but not yet received. If the risk of loss during shipment is yours, you will probably have title to the goods during shipment. If you buy merchandise that is sent C.O.D., title passes when payment and delivery occur.

Goods not yet paid for. You may have title to goods purchased but not yet paid for. If you are billed for merchandise, you must usually pay the bill within a certain time. In this case, you have title to the goods and must include them in inventory, provided they are not sold by the end of the year.

Consignments. Merchandise you receive on consignment is not purchased by you and is never included in your inventory. You have merchandise on consignment if you do not have to pay for what you have in stock until the time you sell it and collect the retail price from the customer.

Identifying the cost. The second step in figuring your inventory is to identify the cost of inventory items. Use the specific identification method when you can identify and match the actual cost to the items in inventory. Most direct sellers will be able to use this method.

If you cannot identify specific items with their invoices, you must make an assumption about which items were sold during the year and which remain. Make this assumption using either the first-in first-out (FIFO) method or the last-in first-out (LIFO) method.

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

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

Valuing the inventory. The third step in figuring your inventory is to value the items you have

in inventory. The value of your inventory is a major factor in figuring your taxable income. The method you use is very important.

The two most common methods to value non-LIFO inventory are the **cost method** and the **lower of cost or market method**. LIFO inventory may only be valued at **cost**.

Cost method. If you use the cost method to value your inventory items, the value of each item is usually its invoice price. Add transportation, shipping, and other necessary costs to acquire the items. Subtract any discounts you received.

Lower of cost or market method. See Publication 538 for a discussion of the lower of cost or market method.

New business. For a new business not using LIFO, you can choose either method to value your inventory. You must use the same method to value your entire inventory and you cannot change the method without first obtaining IRS approval.

Other Income

You must report on your tax return all income you receive from your business unless it is excluded by law. In most cases, your 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. These and other types of income are explained next.

Commissions, bonuses, and percentages. Many direct sellers receive a commission on their sales or purchases. Your commission might be called a “bonus” or “percentage,” and it might be based on both your own sales and the sales of other direct sellers working under you or on purchases from the company with which you are affiliated.

Report the full amount of any commissions you receive as business income, even if you pay part of it to other direct sellers working under you. You can usually deduct the part you pay to others as a business expense. For more information, see *Commissions* under *Other Expenses*, later.

Prizes, awards, and gifts. If you receive prizes, awards, or “gifts” in your role as a direct seller, report their full value as business income. The following are examples of items that must be included in income.

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

Value of goods or services received. Report income received in the form of goods or services at their “fair market value.” Fair market value 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.

Value of use of property. If you receive the free use of property through your direct-sales performance, you must include the fair market value of the use of the property in your business income. There are special rules for the free use of an automobile and certain other property. For more information, see Publication 525.

Capital Expenses

You must capitalize some costs rather than deduct them. These costs are a part of your investment in your business and are called “capital expenses.” When you capitalize a cost, you add it to the basis of the property to which it relates.

Although you generally cannot take a current deduction for a capital expense, you may be able to take deductions for these costs over a period of years as explained later under *Cost Recovery*.

Kinds of Capital Expenses

You must capitalize the following costs.

- **Going into business.** The costs of getting started in business, before you are authorized to start selling your company’s products, are capital expenses. These “start-up costs” include the cost of exploring different direct-selling opportunities, the cost of any training you must have before becoming a direct seller for your product line, any fees you must pay to the company to become a direct seller, and similar costs. See chapter 9 of Publication 535 for information on how to treat these costs.
- **Business assets.** The cost of any asset (property) that will last substantially beyond the tax year it is placed in service is a capital expense. Examples of business assets include: office furniture, business vehicles, and storage shelves. See *Cost Recovery*, later.
- **Improvements.** The costs of making improvements to a business asset are capital expenses if the improvements add to the value of the asset, appreciably lengthen the time you can use it, or adapt it to a different use. However, normal repair expenses are deducted as current business expenses and are not capitalized. For example, if you have a car you use only for business, maintenance and repair costs, such as tune-ups, new headlights, or brake repairs, are business expenses. The cost of overhauling the engine, however, would be a capital expense.

Demonstrators

If you keep your company’s products on hand to show to potential customers, their cost 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 you use yourself is a personal expense,

even if you occasionally show it to prospective customers.

Example. Sheila 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.

Sheila 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 you have a product you use as a demonstrator for one year or less and the demonstrator itself is not available for purchase by your customers, its cost is a business expense.

If the demonstrator itself can be bought by your customers, include it in your 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 as discussed under *Cost of Goods Sold*, earlier.

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 a business expense.

More than one year of use. If you use a demonstrator for more than one year, its cost is a capital expense. However, if you expect to eventually sell the demonstrator, include it in your inventory of goods for sale.

Example 1. Mike sells educational books door-to-door. He carries copies of the books to show. If someone wants a book, he takes a deposit and delivers the book at a later time.

Because his product line changes little from year to year, 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 3 years.

Because Mike eventually sells his demonstrators, they remain 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 as discussed under *Cost Recovery*, next.

Cost Recovery

You can usually “recover” (subtract from income) your cost for capital expenses over a number of years. Each year a part of your basis is recovered through depreciation or amortization. Use depreciation to recover capital expenses for most tangible business assets. Use amortization to recover the cost of intangible assets, such as start-up costs. Amortization is discussed in chapter 9 of Publication 535.

Under certain circumstances, you may be able to recover a limited amount of the cost of qualifying property as a current expense by electing the “section 179 deduction” rather than recover the cost as a capital expense. The “section 179 deduction,” is discussed next.

Form 4562. Generally, use Form 4562 to report depreciation, amortization, and the section 179 deduction. A filled-in Form 4562 is illustrated in an example in Publication 946.

Section 179 Deduction

You can elect to deduct all or part of the cost of certain qualifying property in the year you place it in service. Property is placed in service when it is first made ready and available for a specific use.

Qualifying property. Qualifying property includes tangible personal property for which depreciation is allowable. See chapter 2 in Publication 946 for more information.

Dollar limit. The total section 179 cost you can choose to deduct has increased for 2001. See Publication 553, *Highlights of 2001 Tax Changes*.

Taxable income limit. The total cost you can deduct each year after you apply the dollar limit is further limited to the taxable income from the active conduct of any trade or business during the year.

Any cost not deductible in one year because of this limit can be carried to the next tax year.

More information. For more information, see chapter 2 in Publication 946.

Depreciation

If you do not choose a section 179 deduction or you choose a section 179 deduction and do not recover all your cost, you can take a depreciation deduction for part or all of the cost you did not claim as a section 179 deduction.

Property whose cost can be recovered through depreciation is depreciable property. Depreciable property includes most types of tangible property (except land), such as buildings, machinery, vehicles, furniture, and equipment.

Depreciable property also includes certain intangible property.

You can depreciate property if it meets the following requirements.

- It must be property you own.
- It is used in business or held for the production of income.
- It must have a determinable useful life. This means that it is something that wears out, decays, gets used up, becomes obsolete, or loses value from natural causes.
- It has a useful life that extends substantially beyond the year it is placed in service.

You must use the modified accelerated cost recovery system (MACRS) to depreciate most property placed in service after 1986.

For more information about the depreciation of property placed in service after 1986, see Publication 946. It contains a detailed discussion of MACRS.

For more information about property placed in service before 1987, see Publication 534, *Depreciating Property Placed in Service Before 1987*.

Listed Property

Listed property includes property which lends itself to personal use, such as property used for transportation, entertainment equipment, certain computers, and cellular phones. In addition, there are recordkeeping requirements and rules you must follow when depreciating listed property. If listed property is not used more than 50% for a qualified business purpose during any tax year, you cannot claim the section 179 deduction and special rules apply to the depreciation deduction. See chapter 4 in Publication 946.

Passenger automobiles. For most passenger automobiles, the total depreciation deduction (including the section 179 deduction) you can claim is limited.

For automobiles placed in service during 2001, your depreciation, including the section 179 deduction, cannot be more than \$3,060. For 2002 and 2003, the maximum depreciation deduction for automobiles placed in service in 2001 is \$4,900 and \$2,950, respectively. The maximum depreciation deduction for each year after 2003 is \$1,775.



If your business/investment use of the automobile is less than 100%, you must reduce the maximum deduction amount proportionately.

Example. Peter purchases a car this year for \$4,500 and he uses it 60% for business. He chooses to take a section 179 deduction for the car. The cost of Peter’s car that qualifies for the section 179 deduction is \$2,700 ($\$4,500 \times 60\%$). However, Peter’s section 179 deduction is limited to \$1,836 ($\$3,060 \times 60\%$).

Business Expenses

The operating costs of running your business are called business expenses. These are costs

you do not have to capitalize or include in the cost of goods sold.

Keep business expenses separate from personal expenses. If you have an expense that is part business and part personal, deduct only the business part.

To be deductible, a business expense must be both ordinary and necessary. An **ordinary** expense is one that is common and accepted in your field of business. A **necessary** expense is one that is appropriate and helpful for your business. An expense does not have to be indispensable to be considered necessary.

This section discusses business expenses you might have as a direct seller. For more information on business expenses, see Publication 535.

Salaries and Wages

You can generally deduct the pay you give your employees for the services they perform for your business. The pay may be in cash, property, or services. It may include wages, salaries, vacation allowances, bonuses, commissions, and fringe benefits.

If you are a sole proprietor, you cannot deduct your own salary or any personal withdrawals you make from your business. You are not an employee of the business.

For detailed discussions of salaries, wages, and other payments to employees, see Publications 15, 15–B, and chapter 2 in Publication 535.

Taxes

You can deduct as a business expense various federal, state, local, and foreign taxes directly attributable to your direct-selling business. Some of these taxes were discussed earlier under *Business Taxes* and others are discussed next.

Income taxes. Most income taxes, including federal income taxes, cannot be deducted as a business expense. You can generally deduct personal state and local income taxes as an itemized deduction on Schedule A (Form 1040).

Personal property tax. You can deduct as a business expense any tax imposed by a state or local government on personal property used in your direct-selling business.

You can also deduct registration fees for the right to use property within a state or local area.

Example. May and Julius Winter drove their car 7,000 business miles out of a total of 10,000 miles during the tax year. They had to pay \$25 for their annual state license tags and \$20 for their city registration sticker. They also paid \$235 in city personal property tax on the car, for a total of \$280. They are claiming their actual car expenses for the year. Because they used the car 70% for business, they can deduct 70% of the \$280, or \$196, as a business expense.

Sales tax. Treat any sales tax you pay on a service or on the purchase or use of property as part of the cost of the service or property. If the service or the cost or use of the property is a deductible business expense, you can deduct the tax as part of that service or cost. If the property is merchandise bought for resale, the sales tax is part of the cost of the merchandise. If

the property is depreciable, add the sales tax to the basis for depreciation. See Publication 551, *Basis of Assets*, for information about the basis of property.



Do not deduct state and local sales taxes imposed on the buyer that you must collect and pay over to the state or local government. Do not include these taxes in gross receipts or sales.

Fuel taxes. Taxes on gasoline, diesel fuel, and other motor fuels that you use in your business usually are included as part of the cost of the fuel. Do not deduct these taxes as a separate item.

Interest

Interest is the amount charged for the use of borrowed money. You can generally deduct all interest you pay or accrue during the tax year on a debt related to your business.

You can deduct interest on a debt only if you meet all the following requirements.

- You are legally liable for that debt.
- Both you and the lender intend that the debt be repaid.
- You and the lender have a true debtor-creditor relationship.

No deduction is allowed for interest paid or accrued on personal loans. If a loan is part business and part personal, allocate the interest between the two. For more information, see chapter 5 in Publication 535.

Example. During the tax year, you paid \$600 interest on a car loan. You used the car 60% for business and 40% for personal purposes. You can deduct \$360 (60% × \$600) as a business expense on your Schedule C (Form 1040) or Schedule C–EZ (Form 1040). The remaining interest (\$240) is a nondeductible personal expense.

Insurance

You can generally deduct premiums you pay for the following kinds of insurance related to your trade or business. This list is not all inclusive.

- Fire, theft, flood, or similar insurance.
- Car and truck insurance on vehicles used in your business if you do not use the standard mileage rate to figure your car expenses.
- Credit insurance to cover losses from unpaid debts.
- Liability insurance.
- Use and occupancy and business interruption insurance. This insurance pays for lost profits if your business is shut down due to a fire or other cause. Report the proceeds as ordinary income.

You generally cannot deduct the cost of life insurance paid on your own life. However, see chapter 7 in Publication 535 for information on when life insurance premiums are deductible.

Business and personal. If you pay premiums for insurance coverage that is both business and

personal, deduct only the part that pays for business coverage. For example, if you use your car 25% in your direct-selling business and 75% for personal transportation, you can deduct 25% of your car insurance premiums if you claim actual expenses for the use of the car.

When to deduct. You generally cannot deduct expenses in advance, even if you pay them in advance. This rule applies to both the cash and accrual methods. If you make an advance payment on an insurance policy that provides coverage substantially beyond the end of the current tax year, deduct only the part that buys insurance for the current tax year. You must wait until the following tax year to deduct the part that buys insurance for that year, and so on.

Example. You are a direct seller. In June 2001, you pay \$1,200 in premiums for theft insurance effective July 2001 through June 2003 (\$50 per month). You can deduct \$300 in 2001 (\$50 × 6 months), \$600 in 2002 (\$50 × 12 months), and \$300 in 2003.

Dividends. An insurance dividend is a return of part of the premiums you paid. If you receive dividends from business insurance premiums you deducted in an earlier year, report all or part of the dividend as business income. For more information on recovery of prior deductions, see Publication 525.

Telephone

You cannot deduct the cost of basic local telephone service (including any taxes) for the first telephone line you have in your home, even though you may have an office in your home. However, charges for business long distance phone calls on that line, as well as the cost of a second line into your home used exclusively for business, are deductible business expenses.

Example 1. Leo had a separate telephone line installed in his home for his direct-selling business. He had this phone number printed on his business cards and always uses it only for business calls.

Leo can deduct the full amount of his business phone bill because the phone is used exclusively for business.

Example 2. Mary and George run an active direct-selling business out of their home. For February, their phone bill was \$65 (\$20 for basic telephone service and \$45 for long-distance calls).

The total charge for long-distance business calls on their bill is \$31. Mary and George can deduct \$31 as a business expense.

Away from home. If you travel away from home and make a business phone call, you can deduct the cost of the call, whether or not the rest of your travel expenses are deductible.

Business and personal calls. You can deduct telephone expenses only for business calls. Personal calls do not become business calls because some business is discussed.

Example. Lydia is interested in sponsoring others as direct sellers for her product line. She often talks by phone with her sister who lives 50 miles away. They talk about personal matters. When Lydia mentions her direct-selling work,

she usually says something to encourage her sister to become a direct seller too.

Lydia's phone calls to her sister are personal and nondeductible. Their primary purpose is not to recruit her sister as a direct seller, but to continue their personal relationship.

Other Expenses

Discussed next are other expenses you may have as a direct seller.

Business licenses. License and regulatory fees paid each year to state or local governments are generally deductible business expenses. Some licenses and fees related to starting your business may have to be amortized. See chapter 9 of Publication 535 for more information.

Catalogs. The cost of catalogs you use in your selling business for more than one year must be capitalized. The cost can then be recovered as explained under *Cost Recovery*, earlier. If the catalogs are used in your selling business for one year or less, you can deduct their full cost in the tax year you pay for them.

Commissions. If you must pay a bonus, percentage, or other type of commission to direct sellers working under you, you can deduct it. Report the full amount of any commissions you receive as business income, and deduct the commissions you pay as ordinary and necessary business expenses.

Example. Freda has her own direct-selling business and sponsors two other direct sellers. These direct sellers report their sales to her each month. She in turn adds their sales to hers and reports the total to the direct seller who sponsored her. In March, the people working under her each had \$400 in sales and she had \$500 in sales of her own. She reports to the company (or her sponsor) \$1,300 (\$400 + \$400 + \$500) in monthly sales for her group even though her income is only \$500.

Freda received a commission or "performance bonus" for March equal to 10% of the \$1,300, or \$130, in sales. She reports the entire \$130 as business income on her tax return.

Freda must pay the direct sellers working under her a commission of 7% on their monthly sales of \$400. She paid each of them \$28 (7% of \$400) for their March sales. She deducts the total, \$56, as a business expense on her tax return.

Computer. If you use a computer in your direct sales business, you can depreciate it. However, if you use it 50% or less in your business, you must use the Alternative Depreciation System (ADS) under MACRS to figure your depreciation deduction. For more information, see chapter 4 in Publication 946.

Home meetings. If you have business meetings in your home, you can deduct expenses for the meetings only when they meet certain tests.

- The expenses of entertaining business associates in your home are deductible if they meet the rules discussed under *Meals and Entertainment*, later, and you can prove your expenses as discussed later under *Recordkeeping*.

- The expenses of maintaining your home as a place of business are deductible if you meet the tests discussed under *Business Use of Your Home*, later.

Example. Barbara and Bill hold biweekly 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. The 50% limit is explained later under *Meals and Entertainment*. 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.

Journal subscriptions. If you subscribe to a journal for direct sellers, you can deduct the annual subscription fee as a business expense.

Club dues and membership fees. Generally, you cannot deduct amounts you pay or incur for membership in any club organized for business, pleasure, recreation, or any other social purpose. This includes country clubs, golf and athletic clubs, hotel clubs, sporting clubs, airline clubs, and clubs operated to provide meals under circumstances generally considered to be conducive to business discussions. The purpose and activities of a club, not its name, will determine whether or not you can deduct the dues.

Exception. None of the following organizations will be treated as a club organized for business, pleasure, recreation, or other social purpose, unless one of its main purposes is to conduct entertainment activities for members or their guests or to provide members or their guests with access to entertainment facilities.

- Boards of trade.
- Business leagues.
- Chambers of commerce.
- Civic or public service organizations.
- Professional associations.
- Trade associations.

Legal and professional fees. Legal and professional fees, such as fees charged by accountants, that are ordinary and necessary expenses directly related to operating your business are deductible as business expenses. However, you usually cannot deduct legal fees paid to acquire business assets. Those are added to the basis of the property.

If the fees include payments for work of a personal nature (such as making a will), you can take a business deduction only for the part of the fee related to your business. The personal portion of legal fees for producing or collecting taxable income, doing or keeping your job, or for tax advice may be deductible on Schedule A (Form 1040) if you itemize deductions. See Publication 529, *Miscellaneous Deductions*.

Tax preparation fees. You can deduct as a trade or business expense the cost of preparing

that part of your tax return relating to your business as a sole proprietor. The remaining cost may be deductible on Schedule A (Form 1040) if you itemize deductions.

You can also take a business deduction for the amount you pay or incur in resolving asserted tax deficiencies against your business as a sole proprietor.

Samples and promotional items. You can deduct the cost of samples you give to your customers and the cost of promotional items such as posters. You cannot deduct the cost of any samples you use personally.

Service charges. You can deduct service charges you pay on orders for goods. The service charge can be a flat charge or it can be based on other criteria.

Supplies. Unless you have deducted the cost in any earlier year, you generally can deduct the cost of materials and supplies actually consumed and used during the tax year.

If you keep incidental materials and supplies on hand, you can deduct the cost of the incidental materials and supplies you bought during the tax year if all three of the following requirements are met.

- You do not keep a record of when they are used.
- You do not take an inventory of the amount on hand at the beginning and end of the tax year.
- Your taxable income is clearly reflected by this method.

Business Use of Your Home

Many direct sellers work out of their own homes and have business expenses for using their homes. You can deduct certain expenses for using your home if you meet the following tests.

Qualifying for a Deduction

To deduct expenses related to the business use of your home, you must meet the following tests. Even then your deduction may be limited. See *Deduction limit*, later.

- 1) Your use of the business part of your home must be:
 - a) Exclusive (however, see *Exception under Exclusive use*, later),
 - b) Regular,
 - c) For your trade or business, AND
- 2) The business part of your home must be **one** of the following:
 - a) Your principal place of business,
 - b) A place where you meet or deal with clients or customers in the normal course of your trade or business, or
 - c) A separate structure (not attached to your home) used in connection with your trade or business.

Exclusive use. “Exclusive use” means you use a specific part of your home solely for carrying on your direct-selling business. You do **not** meet the exclusive use test if you use the area in question for your direct-selling business and that same part for personal purposes.

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

Exception. If you use part of your home for the storage of inventory or product samples, you can claim expenses for the business use of your home without meeting the exclusive use test. However, you must meet all the following tests.

- You keep the inventory or product samples for use in your direct-selling business.
- Your home is the **only** fixed location of your business.
- You use the storage space on a regular basis.
- The space you use is separately identifiable and suitable for storage.

Example. Your home is the sole fixed location of your business. You regularly use half your basement for storing inventory as well as for personal purposes. You can deduct the expenses for the storage space even though this part of your basement is not used exclusively for business.

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

Principal place of business. Your home office will qualify as a principal place of business if you meet **both** the following requirements.

- 1) You use it exclusively and regularly for the administrative or management activities of your trade or business.
- 2) You have no other fixed location where you conduct substantial administrative or management activities of your trade or business.

Alternatively, if you do business at more than one location and your home does not qualify as your place of business based on these rules, you determine your principal place of business based on the following factors.

- 1) The relative importance of the activities performed at each location.
- 2) The time spent at each location if the relative importance factor does not determine your principal place of business.

Place to meet clients or customers. If you meet with clients or customers in your home in the normal course of your direct selling business, even though you also carry on business at another location, you can deduct your expenses for the part of your home used exclusively and regularly for business if **both** the following apply.

- You physically meet with clients or customers on your premises.
- Their use of your home is substantial and integral to the conduct of your business.

You do not qualify to deduct expenses for the business use of your home if you have only occasional meetings or telephone calls.

Separate structure. You can deduct the expenses for a separate free-standing structure, such as a studio, garage, or barn, if you use it exclusively and regularly for your business. This structure does not have to be your principal place of business or a place where you meet clients or customers.

Deduction limit. If the gross income from the business use of your home equals or exceeds your total business expenses (including depreciation), you can deduct all your business expenses. If your gross income is less than your total business expenses, the deduction for certain expenses for the business use of your home is limited.

Where to deduct. If you qualify to deduct expenses for the business use of your home, you must figure your deduction on Form 8829 and attach it to Form 1040. You deduct the expenses on Schedule C (Form 1040).

More information. For more information, including how to figure the deduction, see Publication 587.

Travel and Local Transportation

Travel expenses generally are those business related expenses for trips that require you to spend the night away from home – for example, the cost of travel to a distant city to attend a business-related function or convention. Local transportation expenses generally are those business related expenses for trips you make in the area of your tax home – for example, the cost of transportation to call on customers or make deliveries in the city where you work and its suburbs.

You must be able to prove your expenses for travel and transportation. Deductions for travel and transportation are looked at closely when the IRS examines returns. For more information, see *Recordkeeping*, later.

Travel

Generally, your tax home is your regular place of business or post of duty, regardless of where you maintain your family home.

If you temporarily travel away from your tax home on business, you can deduct your ordinary and necessary travel expenses. You cannot deduct lavish or extravagant expenses or those for personal or vacation purposes.

You can deduct all your travel expenses, subject to certain limits, if your trip was entirely business related. This includes expenses for attending a seminar, meeting, convention, or other function if you can show that your attendance benefits your business. If your trip was primarily for business and, while at your busi-

ness destination, you extended your stay for a vacation, made a nonbusiness side trip, or had other nonbusiness activities, you can deduct only your business-related travel expenses. These expenses include the travel costs of getting to and from your business destination and any business-related expenses at your business destination.

Example. You live in and conduct your direct selling business from Atlanta and take a business trip to New Orleans. On your way home, you stop in Mobile to visit your parents. You spend \$830 for the 9 days you are away from home for transportation, meals, lodging, and other travel expenses. If you had not stopped in Mobile, you would have been gone only 6 days, and your total cost would have been \$730. You can deduct \$730 for your trip, including the cost of round-trip transportation to and from New Orleans. The cost of your meals is subject to the 50% limit on meals explained later.

If your trip was primarily for personal reasons, such as a vacation, the entire cost of the trip is a nondeductible personal expense. However, you can deduct any expenses you have while at your destination that are directly related to your business.

For more information, see Publication 463.

Local Transportation

You can deduct local transportation expenses for your business. Generally, local transportation expense is the cost of getting from one workplace to another in the course of your business when traveling within the city or general area that is your tax home, or of getting from your home to a temporary work location. It includes the following kinds of trips you make in the area where you live and work.

- Visiting clients or customers.
- Attending business meetings away from your workplace.

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

Commuting expenses. You cannot deduct the cost of transportation between your home and your main or regular place of work. The cost of commuting is a nondeductible personal expense, 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. If you work at two places in one day, you can deduct the expense of getting from one workplace to the other. How-

ever, if you do not go directly from one location to the other, deduct only the amount it would have cost you to go directly from the first location to the second.

Deductible expenses. If you use your vehicle in your business, see Publication 463 for information on how to figure your expenses for business transportation.

Meals and Entertainment

Because you are in the selling business, you may take business associates to lunch or otherwise entertain them. The cost can be a deductible business expense. However, certain conditions must be met before you can take a deduction for business meals and entertainment, and you generally can deduct only 50% of the cost. This section discusses those rules.

Meals. Include as meals the amounts spent on food and beverages and the taxes and tips on those amounts. Generally, no deduction is allowed unless you or your employee is present when the food or beverages are provided.

Entertainment. Include as entertainment any activity generally considered to provide entertainment, amusement, or recreation. This includes entertaining guests at nightclubs; social, athletic, and sporting clubs; theaters; sporting events; on yachts; and on hunting, fishing, and vacation trips or on similar outings. It can also include meeting your customers' personal, living, or family needs, such as furnishing a hotel suite or a car. However, see *Not directly related*, later.

Directly Related or Associated

To be deductible, meal and entertainment expenses must be ordinary and necessary expenses of carrying on your direct-selling business and you must be able to prove them as explained later under *Proving Your Deductions*. Unless certain exceptions apply, you must be able to show that they are "directly related" to or "associated" with the active conduct of your business.

For more information, see chapter 2 of Publication 463.

Directly related. For meal and entertainment expenses to meet the directly-related test, all the following must apply.

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



TIP You do 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 meal or entertainment. However, if the business discussion is only incidental to the meal or entertainment, it does not qualify as directly related.

Example. You are a direct seller of women's cosmetics. A state women's organization is holding its annual convention in a local hotel and you decide to display your products in a hospitality room in the hotel. You also provide entertainment and give out product samples. You can deduct the cost of the hospitality room and entertainment provided.

Not directly related. Generally, expenses are not directly related if you are not there or there are substantial distractions that prevent you from actively conducting business. The following are situations where there are substantial distractions.

- 1) A meeting or discussion at a nightclub, theater, or sporting event.
- 2) A meeting or discussion during what is essentially a social gathering, such as a cocktail party.
- 3) 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.

You may prove the meal or entertainment is directly related by clearly establishing you had a substantial business discussion during the meal or entertainment.

When meals and entertainment take 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 you clearly show otherwise.

Associated. You can deduct meal and entertainment expenses that do not meet the directly-related test if both the following apply.

- The expenses are associated with your direct-selling business.
- The meal or entertainment is directly before or after a substantial business discussion.

An ordinary and necessary meal or entertainment expense is generally associated with your direct-selling business if you can show you had 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. You must show that you actively engaged in a discussion, meeting, negotiation, or other business transaction to get income for your business or another specific business benefit.

The meeting does not have to be for a specified length of time. However, you must show that the business discussion was substantial in relation to the meal or entertainment. It is not necessary to devote more time to business than to the meal or entertainment and you do not have to

discuss business during the meal or entertainment.

Business and nonbusiness guests. You must divide your entertainment expenses between business and nonbusiness expenses. You can deduct only the business part. If you cannot establish the part of the expense for each person participating, you can allocate the expense to each participant on a pro-rata basis. For example, if you entertain a group of 11 (including yourself)—three business prospects and seven social guests—deduct only four-elevenths of the expense.

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

Example. You entertain a business customer. The cost is an ordinary and necessary business expense and is allowed under the entertainment rules. The customer's spouse joins you because it is impractical to entertain the customer without the spouse. You can deduct the cost of entertaining the customer's spouse as an ordinary and necessary business expense. Furthermore, if your spouse joins the party because the customer's spouse is present, the cost of the entertainment for your spouse is also an ordinary and necessary business expense.

Lavish or extravagant expenses. You cannot deduct expenses for meals and entertainment to the extent they are lavish or extravagant. 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.

Your meals. Generally, you can deduct your business meal expenses while traveling away from home for business (other than lavish or extravagant amounts). However, if you entertain a business customer locally and the conditions discussed earlier are met, the cost of your own meal is deductible only to the extent the cost exceeds the amount you would normally have spent for personal purposes.

Limit

You can usually deduct only 50% of your unreimbursed business-related meal and entertainment expenses. The 50% limit applies, for example, to expenses you incur while traveling away from home on business (whether eating alone or with others), entertaining business customers at your place of business or a restaurant, or attending a business function, convention, or reception.

Taxes and tips related to a business meal or entertainment activity are included in the amount subject to the 50% limit. Expenses such as cover charges to a nightclub, rent for a room where you hold a dinner or cocktail party, or the amount paid for parking at a sports arena are subject to the 50% limit. However, the cost of transportation to and from an otherwise allowa-

ble business meal or entertainment activity is not subject to the 50% limit.

If you pay or have an expense for goods and services consisting of meals, entertainment, and other services (such as lodging or transportation), you must reasonably allocate the expense between the cost of meals and entertainment and the cost of other services. For example, you must make an allocation if a hotel includes one or more meals in its room charge.

Apply the 50% limit after figuring the amount that would otherwise qualify for a deduction. First determine the amount of meal and entertainment expenses that would be deductible under the rules discussed earlier. Then apply the 50% limit to figure the deductible amount.

Example. You spend \$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. You cannot deduct more than \$30 (50% of \$60).

Exceptions to the 50% limit are discussed in Publication 463.

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 situations illustrated next, you can deduct the cost as a business expense.

Situation 1. You do your direct selling on the sales party plan. As an incentive for people to host your parties, you offer 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, your gift to the host or hostess is actually payment for hosting the party, and the host or hostess must report the fair market value of the gift as income.

You can deduct the cost of the gift. If you give hosts and hostesses items from your inventory or items you purchase from the company at the same time you purchase goods you sell, their cost will be included in the cost of goods sold. You cannot deduct their cost again as a business expense. However, if you purchase the gifts separately from the goods you sell, deduct their cost as an ordinary and necessary business expense.

Situation 2. You have several direct sellers working under you. Because your income depends in part on their sales, you regularly meet with them, encourage them, and provide them with incentives and support. As an incentive to make sales, you sometimes offer 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 you give are actually payments for the winners' selling efforts. You can deduct the cost of the prizes as ordinary and necessary business expenses. The direct sellers who receive your incentive prizes must report them as income at their fair market value. For more information, see *Other Income*, earlier.

Situation 3. You sell cosmetics door-to-door. To spur sales, you often give away small samples.

In this situation, you can deduct the cost of the samples. If you purchase samples separately from the products you sell, you can deduct their costs as an ordinary and necessary business expense.

Do not deduct the cost of the same item twice. If the item was included in inventory, you cannot later deduct it as a business expense. The item will already be part of the cost of goods sold.

Gift limit. You cannot deduct more than \$25 for business gifts you give directly or indirectly to any one person during the year (see the exceptions discussed later). Personal gifts are not deductible.

Figuring the limit. A gift to the spouse (or family member) of a customer is generally considered an indirect gift to the customer. However, if you have 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 you and your spouse both give gifts, you are treated as one taxpayer for the \$25 limit. It does not matter whether you 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.

- Items that cost \$4 or less, on which your business name is clearly and permanently imprinted and which are part of a number of identical items you widely distribute. This includes such items as pens, desk sets, and plastic bags and cases.
- 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 and not subject to the \$25 limit. However, if you give a customer packaged food or beverages to be used later, they are gifts.

If you provide business associates with tickets to a theater performance or a sporting event and you do not accompany them, you may treat the tickets as either a gift or entertainment, whichever is to your advantage. However, if you go to the event with them, you must treat the cost of the tickets as an entertainment expense.

Not-for-Profit Limit

If you do not carry on your direct-selling activity to make a profit, there is a limit on the deductions you can take. If the not-for-profit limits apply, you cannot use a loss from direct selling to offset any other income.

This limit applies, for example, if you go into direct selling primarily for the business deductions you can take. It also applies if you become a direct seller only so you and your friends can buy products at reduced rates.

If the not-for-profit limit applies, you must take the deductions allowed on Schedule A (Form 1040). See *Limit on Deductions and Losses under Not-for-Profit Activities* in chapter 1 of Publication 535 for information on how to figure your allowable deductions. Do not use a business tax return, such as Schedule C (Form 1040).

Not for profit. In deciding whether your direct selling is carried on for profit, take into account all facts about the activity. No one factor alone is decisive. The following are factors to consider.

- Whether you carry on your direct selling in a businesslike manner and maintain complete and accurate books and records.
- Whether the time and effort you put into direct selling indicates you intend to make it profitable.
- Whether you are depending on income from direct selling for your livelihood.
- Whether your losses are due to circumstances beyond your control (or are normal in the start-up phase of direct selling).
- Whether you change your methods of operation in an attempt to improve profitability.
- Whether you, or your advisors, have the knowledge needed to carry on direct selling as a successful business.
- Whether you were successful in making a profit in similar activities in the past.
- Whether your direct selling makes a profit in some years and how much profit it makes.
- Whether you can expect to make a future profit from the appreciation of the assets used in your direct-selling business.

If the IRS inquires about your tax return, you may be asked to provide proof that your direct selling activity is carried on for profit. However, your direct selling is presumed to be carried on for profit if it produced a profit in at least 3 of the last 5 tax years, including the current year, unless the IRS establishes otherwise.

If you are starting a business and do not have 3 years showing a profit, you may want to elect to have the presumption made, after you have the 5 years of experience allowed by the test. For more information on postponing any determination that your direct selling is not carried on for profit, see *Using the presumption later* under *Not-for-Profit Activities* in chapter 1 of Publication 535.

Recordkeeping



You must keep records to correctly figure your taxes. Your records must be permanent, accurate, complete, and clearly establish your income, deductions, and credits. The law does not require you to keep records in any particular way. But if you have more than one business, you should keep a complete and separate set of books and records for each business.

Publication 583 provides information about setting up a recordkeeping system, the types of books and records included in a typical system for a small business, and sample records.

Publication 463 provides information on the records to keep if you use your car in your business.

The following are suggestions for keeping adequate business records.

- **Keep a business bank account.** Deposit all business receipts in a separate bank account. Make all payments by check, if possible. Then business income and business expenses will be well documented.
- **Make a record.** Record all your business transactions in separate account books and keep a monthly summary of your business income and expenses.
- **Keep your records.** You must keep your business books and records available at all times for inspection by the IRS. You must keep the records as long as they may be needed in the administration of any Internal Revenue law. You should also keep copies of your tax returns to help prepare future returns or file claims for refunds.
- **Support your entries.** File canceled checks, paid bills, duplicate deposit slips, and other items that support entries in your books in an orderly manner and store them in a safe place. For instance, organize them by year and type of expense.

If you cannot provide a canceled check to prove payment of an expense item, you may be able to prove it with certain financial account statements. These include account statements prepared for the financial institutions by a third party. These account statements must be highly legible. The following table lists acceptable account statements.

IF payment is by...	THEN the statement must show the...
Check	<ul style="list-style-type: none"> • Check number • Amount • Payee's name • Date the check amount was posted to the account by the financial institution

Electronic funds transfer	<ul style="list-style-type: none"> • Amount transferred • Payee's name • Date the transfer was posted to the account by the financial institution
Credit card	<ul style="list-style-type: none"> • Amount charged • Payee's name • Transaction date



Proof of payment alone does not establish that you are entitled to a tax deduction. You should also keep other documents as discussed in Proving Your Deductions, next.

Proving Your Deductions

The IRS may ask you to prove your deductions for business expenses.

Travel Expenses

For travel expenses, you must be able to prove the following items.

- Each separate amount you spent for travel away from home, such as the cost of your transportation or lodging. A receipt, bill, or other documentary evidence generally is required for all lodging expenses. You can total the daily cost of your breakfast, lunch, dinner, and other incidental travel costs if they are listed in reasonable categories, such as meals, gas and oil, and taxi fares.
- The dates you left and returned home for each trip, and the number of days spent on business while traveling away from home.
- The destination or area of your travel, described by the name of the city or town.
- The business reasons for your travel or the business benefit you gained or expected to gain from it.

Entertainment Expenses

For entertainment expenses, including entertainment-related meals, you must be able to prove the following.

- 1) The amount of each separate entertainment expense. You can total incidental expenses, such as taxi fares and telephone calls, on a daily basis.
- 2) The date the entertainment took place.
- 3) The name and address or location of the place you went. Include the type of entertainment, such as dinner or the theater, if the information is not clear from the name or designation of the place.
- 4) The occupation or other information about the persons for whom you are claiming a meal or entertainment expense. Include their names, titles, or other information sufficient to establish their business relationship to you.

- 5) The business reason for the entertainment or the business benefit you gained or expected to gain from it and the nature of any business discussion or activity that took place.
- 6) The presence of you or your employee at a business meal given for a client.

Business discussion. If the entertainment took place before or after a substantial and bona fide business discussion, in addition to the information in (1), (2), (3), (4), and (6) above, you must be able to prove the following.

- The date, place, and duration of the business discussion.
- The nature of the business discussion.
- The business reason for the meal or entertainment or the business benefit you gained or expected to gain from entertaining.
- The identification of the persons who participated in both the business discussion and the entertainment activity.

Business relationship. If you entertain a readily identifiable group of people, you do not have to record the name of each person. It is enough to designate the group. For example, if you entertain all the members of a garden club, an entry such as "members of the Hillcrest Garden Club" is enough.

Gift Expenses

For gift expenses, you must be able to prove the following.

- The cost of the gift.
- The date you gave the gift.
- A description of the gift.
- Your reason for giving the gift or any business benefit you gained (or expected to gain) from giving it.
- The occupation or other information about the person receiving the gift, including name, title, or other information establishing a business relationship to you.

The name of the recipient of a business gift does not always have to be recorded. A general listing will be enough if it is evident that you are not trying to avoid the \$25 annual limit on the deduction for gifts to any one person. For example, if you buy a large number of tickets to local high school basketball games and give one or two tickets to each of a number of customers, it is usually enough to record a general description of the recipients.

Records

You should keep proof of travel, meal, entertainment, and gift expenses in an account book, diary, statement of expense, or similar record. You should also keep adequate documentary evidence to support each element of an expense.

You do not have to record information shown on a receipt if your records and receipts complement each other in an orderly manner.

Keep your records up to date. Record your expenses in your account book at or near the time of the expense. Entries made later, when you may not remember them accurately, do not have as much value as entries made at or near the time of the expense.

Separating expenses. Usually, each separate payment you make must be recorded as a separate expense. For example, if you entertain someone at dinner and then go to the theater, the dinner expense and the cost of the theater tickets are separate expenses. You must record them separately in your records.

Expenses of a similar nature occurring during the course of a single event will be considered a single expense. For example, if during entertainment at a cocktail lounge you pay separately for each serving of refreshments, treat the total expense for the refreshments as a single expense.

Some items can be totaled in categories. You can make one daily entry for such categories as taxi fares, telephone calls away from home, gas and oil, and other incidental travel costs. Meals should be a separate category. Include tips with the costs of the services you received.

Documentary evidence. A receipt or bill is often the best evidence to prove the amount of an expense. Documentary evidence is needed for all your lodging expenses unless, under an accountable plan, your employer pays you a per diem reimbursement of no more than the government rate in effect at that time and in that area. It is also generally needed for any other expense of \$75 or more.

Documentary evidence will ordinarily be considered adequate if it shows the amount, date, place, and essential character of the expense. For example, a hotel receipt is enough to support expenses for business travel if it has the name and location of the hotel, the dates you stayed there, and separate amounts for charges such as lodging, meals, and telephone. A restaurant receipt is enough to prove an expense for a business meal if it has the name and location of the restaurant, the number of people served, and the date and amount of the expense. If a charge is made for items other than meals and beverages, the receipt must show that this is the case.

Canceled check. A canceled check, together with a bill from the payee, usually establishes the cost. However, a canceled check by itself does not prove a business expense without other evidence to show a business purpose.

Incomplete records. If you do not have adequate records to prove an element of an expense, you must prove the element by providing both of the following.

- Your own statement, whether written or oral, containing specific information about the element.
- Other supporting evidence sufficient to establish the element.

Additional proof. You may be required to provide additional information to the IRS to clarify or establish the accuracy or reliability of the information in your records, statements, testimony, or documentary evidence.

How To Get Tax Help

You can get help with unresolved tax issues, order free publications and forms, ask tax questions, and get more information from the IRS in several ways. By selecting the method that is best for you, you will have quick and easy access to tax help.

Contacting your Taxpayer Advocate. If you have attempted to deal with an IRS problem unsuccessfully, you should contact your Taxpayer Advocate.

The Taxpayer Advocate represents your interests and concerns within the IRS by protecting your rights and resolving problems that have not been fixed through normal channels. While Taxpayer Advocates cannot change the tax law or make a technical tax decision, they can clear up problems that resulted from previous contacts and ensure that your case is given a complete and impartial review.

To contact your Taxpayer Advocate:

- Call the Taxpayer Advocate at **1-877-777-4778**.
- Call the IRS at **1-800-829-1040**.
- Call, write, or fax the Taxpayer Advocate office in your area.
- Call **1-800-829-4059** if you are a TTY/TDD user.

For more information, see Publication 1546, *The Taxpayer Advocate Service of the IRS*.

Free tax services. To find out what services are available, get Publication 910, *Guide to Free Tax Services*. It contains a list of free tax publications and an index of tax topics. It also describes other free tax information services, including tax education and assistance programs and a list of TeleTax topics.



Personal computer. With your personal computer and modem, you can access the IRS on the Internet at www.irs.gov. While visiting our web site, you can:

- Find answers to questions you may have.
- Download forms and publications or search for forms and publications by topic or keyword.
- View forms that may be filled in electronically, print the completed form, and then save the form for recordkeeping.
- View Internal Revenue Bulletins published in the last few years.
- Search regulations and the Internal Revenue Code.

- Receive our electronic newsletters on hot tax issues and news.
- Get information on starting and operating a small business.

You can also reach us with your computer using File Transfer Protocol at ftp.irs.gov.



TaxFax Service. Using the phone attached to your fax machine, you can receive forms and instructions by calling **703-368-9694**. Follow the directions from the prompts. When you order forms, enter the catalog number for the form you need. The items you request will be faxed to you.

For help with transmission problems, call the FedWorld Help Desk at **703-487-4608**.



Phone. Many services are available by phone.

- *Ordering forms, instructions, and publications.* Call **1-800-829-3676** to order current and prior year forms, instructions, and publications.
- *Asking tax questions.* Call the IRS with your tax questions at **1-800-829-1040**.
- *TTY/TDD equipment.* If you have access to TTY/TDD equipment, call **1-800-829-4059** to ask tax questions or to order forms and publications.
- *TeleTax topics.* Call **1-800-829-4477** to listen to pre-recorded messages covering various tax topics.

Evaluating the quality of our telephone services. To ensure that IRS representatives give accurate, courteous, and professional answers, we evaluate the quality of our telephone services in several ways.

- A second IRS representative sometimes monitors live telephone calls. That person only evaluates the IRS assistor and does not keep a record of any taxpayer's name or tax identification number.
- We sometimes record telephone calls to evaluate IRS assistants objectively. We hold these recordings no longer than one week and use them only to measure the quality of assistance.
- We value our customers' opinions. Throughout this year, we will be surveying our customers for their opinions on our service.



Walk-in. You can walk in to many post offices, libraries, and IRS offices to pick up certain forms, instructions, and publications. Some IRS offices, libraries, grocery stores, copy centers, city and county governments, credit unions, and office supply stores have an extensive collection of products available to print from a CD-ROM or photocopy from reproducible proofs. Also, some IRS offices and libraries have the Internal Revenue Code, regulations, Internal Revenue Bulletins, and Cumulative Bulletins available for research purposes.



Mail. You can send your order for forms, instructions, and publications to the Distribution Center nearest to you and receive a response within 10 workdays after your request is received. Find the address that applies to your part of the country.

- **Western part of U.S.:**
Western Area Distribution Center
Rancho Cordova, CA 95743-0001
- **Central part of U.S.:**
Central Area Distribution Center
P.O. Box 8903
Bloomington, IL 61702-8903
- **Eastern part of U.S. and foreign addresses:**
Eastern Area Distribution Center
P.O. Box 85074
Richmond, VA 23261-5074



CD-ROM. You can order IRS Publication 1796, *Federal Tax Products on CD-ROM*, and obtain:

- Current tax forms, instructions, and publications.
- Prior-year tax forms and instructions.
- Popular tax forms that may be filled in electronically, printed out for submission, and saved for recordkeeping.
- Internal Revenue Bulletins.

The CD-ROM can be purchased from National Technical Information Service (NTIS) by calling **1-877-233-6767** or on the Internet at www.irs.gov. The first release is available in mid-December and the final release is available in late January.

IRS Publication 3207, *Small Business Resource Guide*, is an interactive CD-ROM that contains information important to small businesses. It is available in mid-February. You can get one free copy by calling **1-800-829-3676** or visiting the IRS web site at www.irs.gov.

Index

A	Direct seller, defined 2	Inventory 5	S
Accounting methods 4			Salaries and wages 7
Accounting periods 4	E	L	Samples 9
Assistance (<i>See Tax help</i>)	Employer identification number 2	Legal fees 9	Section 179 deduction 7
	Entertainment 10	Licenses 8	Subscriptions 9
B		Listed property 7	Suggestions 2
Bonuses 6	F		Supplies 9
Business:	Free tax services 14	M	
Expenses 7		Meals 10	T
Income 4	G	Membership fees 9	Tax help 14
Not for profit 12	Gifts 11	More information (<i>See Tax help</i>)	Taxes:
	Gross profit 5		Employment 3
C		N	Estimated 3
Capital expenses 6	H	Not-for-profit limit 12	Income 3, 7
Catalogs 8	Help (<i>See Tax help</i>)		Personal property 7
Club dues 9	Home:	P	Sales 7
Comments 2	Business use 9	Passenger automobiles 7	Self-employment 3
Commissions 6, 8	Meetings 8	Penalties 3	Taxpayer Advocate 14
Commuting costs 10	Host or hostess 2	Prepaid expenses 4	Telephone 8
Computer 8		Prizes and awards 6	Transportation, local 10
Cost of goods sold 5	I	Professional fees 9	Travel 10
Cost recovery 7	Income from sales 4	Publications (<i>See Tax help</i>)	TTY/TDD information 14
	Information returns 3	Purchases 5	
D	Insurance 8		
Demonstrators 6	Interest 8	R	
Depreciation 7		Recordkeeping 12	

Tax Publications for Business Taxpayers

See *How To Get Tax Help* for a variety of ways to get publications, including by computer, phone, and mail.

General Guides

- 1** Your Rights as a Taxpayer
- 17** Your Federal Income Tax (For Individuals)
- 334** Tax Guide for Small Business (For Individuals Who Use Schedule C or C-EZ)
- 509** Tax Calendars for 2002
- 553** Highlights of 2001 Tax Changes
- 910** Guide to Free Tax Services

Employer's Guides

- 15** Circular E, Employer's Tax Guide
- 15-A** Employer's Supplemental Tax Guide
- 15-B** Employer's Tax Guide to Fringe Benefits
- 51** Circular A, Agricultural Employer's Tax Guide
- 80** Circular SS, Federal Tax Guide For Employers in the U.S. Virgin Islands, Guam, American Samoa, and the Commonwealth of the Northern Mariana Islands
- 179** Circular PR Guía Contributiva Federal Para Patronos Puertorriqueños
- 926** Household Employer's Tax Guide

Specialized Publications

- 225** Farmer's Tax Guide
- 378** Fuel Tax Credits and Refunds
- 463** Travel, Entertainment, Gift, and Car Expenses

- 505** Tax Withholding and Estimated Tax
- 510** Excise Taxes for 2002
- 515** Withholding of Tax on Nonresident Aliens and Foreign Entities
- 517** Social Security and Other Information for Members of the Clergy and Religious Workers
- 527** Residential Rental Property
- 533** Self-Employment Tax
- 534** Depreciating Property Placed in Service Before 1987
- 535** Business Expenses
- 536** Net Operating Losses (NOLs) for Individuals, Estates, and Trusts
- 537** Installment Sales
- 538** Accounting Periods and Methods
- 541** Partnerships
- 542** Corporations
- 544** Sales and Other Dispositions of Assets
- 551** Basis of Assets
- 556** Examination of Returns, Appeal Rights, and Claims for Refund
- 560** Retirement Plans for Small Business (SEP, SIMPLE, and Qualified Plans)
- 561** Determining the Value of Donated Property
- 583** Starting a Business and Keeping Records
- 587** Business Use of Your Home (Including Use by Day-Care Providers)
- 594** The IRS Collection Process
- 595** Tax Highlights for Commercial Fishermen

- 597** Information on the United States-Canada Income Tax Treaty
- 598** Tax on Unrelated Business Income of Exempt Organizations
- 686** Certification for Reduced Tax Rates in Tax Treaty Countries
- 901** U.S. Tax Treaties
- 908** Bankruptcy Tax Guide
- 911** Direct Sellers
- 925** Passive Activity and At-Risk Rules
- 946** How To Depreciate Property
- 947** Practice Before the IRS and Power of Attorney
- 954** Tax Incentives for Empowerment Zones and Other Distressed Communities
- 1544** Reporting Cash Payments of Over \$10,000
- 1546** The Taxpayer Advocate Service of the IRS

Spanish Language Publications

- 1SP** Derechos del Contribuyente
- 579SP** Cómo Preparar la Declaración de Impuesto Federal
- 594SP** Comprendiendo el Proceso de Cobro
- 850** English-Spanish Glossary of Words and Phrases Used in Publications Issued by the Internal Revenue Service
- 1544SP** Informe de Pagos en Efectivo en Exceso de \$10,000 (Recibidos en una Ocupación o Negocio)

Commonly Used Tax Forms

See *How To Get Tax Help* for a variety of ways to get forms, including by computer, fax, phone, and mail. Items with an asterisk are available by fax. For these orders only, use the catalog number when ordering.

Form Number and Title	Catalog Number	Form Number and Title	Catalog Number
W-2 Wage and Tax Statement	10134	1120S U.S. Income Tax Return for an S Corporation	11510
W-4 Employee's Withholding Allowance Certificate*	10220	Sch D Capital Gains and Losses and Built-In Gains	11516
940 Employer's Annual Federal Unemployment (FUTA) Tax Return*	11234	Sch K-1 Shareholder's Share of Income, Credits, Deductions, etc.	11520
940-EZ Employer's Annual Federal Unemployment (FUTA) Tax Return*	10983	2106 Employee Business Expenses*	11700
941 Employer's Quarterly Federal Tax Return	17001	2106-EZ Unreimbursed Employee Business Expenses*	20604
1040 U.S. Individual Income Tax Return*	11320	2210 Underpayment of Estimated Tax by Individuals, Estates, and Trusts*	11744
Sch A & B Itemized Deductions & Interest and Ordinary Dividends*	11330	2441 Child and Dependent Care Expenses*	11862
Sch C Profit or Loss From Business*	11334	2848 Power of Attorney and Declaration of Representative*	11980
Sch C-EZ Net Profit From Business*	14374	3800 General Business Credit	12392
Sch D Capital Gains and Losses*	11338	3903 Moving Expenses*	12490
Sch D-1 Continuation Sheet for Schedule D	10424	4562 Depreciation and Amortization*	12906
Sch E Supplemental Income and Loss*	11344	4797 Sales of Business Property*	13086
Sch F Profit or Loss From Farming*	11346	4868 Application for Automatic Extension of Time To File U.S. Individual Income Tax Return*	13141
Sch H Household Employment Taxes*	12187	5329 Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts	13329
Sch J Farm Income Averaging*	25513	6252 Installment Sale Income*	13601
Sch R Credit for the Elderly or the Disabled*	11359	8283 Noncash Charitable Contributions*	62299
Sch SE Self-Employment Tax*	11358	8300 Report of Cash Payments Over \$10,000 Received in a Trade or Business*	62133
1040-ES Estimated Tax for Individuals*	11340	8582 Passive Activity Loss Limitations*	63704
1040X Amended U.S. Individual Income Tax Return*	11360	8606 Nondeductible IRAs*	63966
1065 U.S. Return of Partnership Income	11390	8822 Change of Address*	12081
Sch D Capital Gains and Losses	11393	8829 Expenses for Business Use of Your Home*	13232
Sch K-1 Partner's Share of Income, Credits, Deductions, etc.	11394		
1120 U.S. Corporation Income Tax Return	11450		
1120-A U.S. Corporation Short-Form Income Tax Return	11456		