ACCOUNTING FOR YOUR MARY KAY BUSINESS
Tax Information for year ending 2010

1. Start-up Business Procedures
   a) Establish a separate business bank account
   b) Establish a separate business credit card account
   c) Do NOT mix business and personal expense in bank or credit card accounts

2. Basic Bookkeeping
   a) Recap expenses on a periodic basis (weekly, monthly, annually)
   b) Reconcile bank and credit card statements routinely
   c) Record mileage routinely-Beginning Odometer and Ending Odometer along with business miles out of total miles for the year
   d) Take a physical inventory count at year end at cost—do not include sales tax or Section 2 items
      i) Section 1 purchases from order computer print-outs
      ii) Personal use, demonstrator & product give-away totals pulled from inventory as separate listings

3. Tax Considerations - Think of expenditures/transactions in terms of "how can this be a deductible business expense?"
   a) Automobile expense - a log is required with actual or mileage rate deduction method
      i) Actual - Gasoline, oil, tires, insurance, taxes/registration, repairs and maintenance, date of purchase, cost, garage rent, & depreciation **or**
      ii) Standard mileage rate - number of miles x current rate (50 cents for 2010 and 51 cents for 2011) **plus** parking, tolls, interest, and taxes/registration. You will need the percentage of business use to take interest and taxes/registration.
      iii) Mileage may be done on a periodic basis. For example, log mileage for a representative month and multiply your results by twelve. **Hint:** Service records are a great source for beginning of the year and end of the year mileage.
   b) Home Office
      i) "exclusively used on a regular basis"
         a) Principal **place of business** for **any trade or business** of the taxpayer
         b) As a place of business used by clients/customers in meeting or dealing with the taxpayer in the normal course of trade of business
         c) A separate structure not attached to the dwelling unit in conjunction with a trade or business
      ii) Exception to "exclusive" use rule:
         a) Only fixed location to meet clients or do administrative tasks
         b) Inventory storage
         c) Separate facility (e.g. detached garage)
      iii) Potentially deductible direct & indirect expenses - Need square footage of entire home **and** square footage of business portion.
         a) Mortgage interest (Form 1098)
         b) Real Estate taxes (Form 1098 or Property Tax Schedule)
         c) Homeowners Insurance
         d) Utilities, including trash
         e) Repairs & maintenance - may include maid and lawn service
         f) Purchase price of home (HUD-1 Form--closing document)
         g) Rent
         h) Telephone line-second line (first line into house is **not** deductible)

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- iv) Special note - The eventual sale of a personal residence used for both personal and business **will** result in the recapture of depreciation.

c) Meals & Entertainment
- i) Deductible when either
  - a) directly related (actual benefit) or
  - b) "associated with" and preceded or followed by substantial business purpose/discussion
    - (1) may be for established or **prospective** clients and consultants
- ii) Limited to 50% and must not be extravagant. Extravagant portion reduced from total prior to taking the 50% deduction.
- iii) Per diem allowed for meals and incidents **only** ($46) within the continental US

d) Travel should be reasonable:
- i) Airfare - deductible where **primary** purpose is business related
- ii) Expenses may include:
  - a) Rental Car and related expenses (e.g. parking, tolls, fuel, etc.)
  - b) Hotel
  - c) Meals and Entertainment – limited to 50% of total
  - d) Incidental expenses (e.g. dry cleaning, taxi, shuttles and tips)
- iii) Generally, may not include spouse's travel.

e) Documentation Issues
- i) Cellular phones – who, when, where and business purpose for each call
- ii) Computer – percentage of time used for business
- iii) Meals and Entertainment receipts and/or log should show who, where, cost (including tax and tips), and business purpose
- iv) Mileage log to include date, miles traveled and purpose (may be able to use a "sample"). This may be done via a travel log, diary or trip sheet.
- v) Travel receipts should include receipts for all amounts over $75, except for hotels which always require an invoice
- vi) Sales tickets-pink sheets
- ***vii)*** ***Hint:*** Keep an envelope or Ziploc bag in your auto glove box for receipts

4. Sole Proprietor Forms

a) Form 1040—U.S. Individual Income Tax Return

b) Form 1040-ES—Estimated Tax For Individuals

c) Schedule C - Profit or Loss From Business

d) Schedule SE - Self-Employment Tax
- i) Social Security cap 2010-$106,800
- ii) Social Security cap 2011-$106,800

e) Form 4562 - Depreciation and Amortization
- i) Section 179 limit 2010-$500,000
- ii) Section 179 limit 2011-$500,000
- iii) Bonus depreciation – 100%

f) Form 8829 - Expenses for Business Use of Your Home

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5. Retirements Plan options
   a) Regular IRA contribution ($5,000 with $1,000 catch-up)
   b) Simplified Employee Plan (SEP)
   c) SIMPLE Plan ($11,500 with $2,500 catch-up 2010)
   d) Money Purchase Pension Plan
   e) 401(k) and Roth 401(k) ($16,500 with $5,500 catch-up 2010 and 2011)
6. Miscellaneous items:
   a) Other mileage rates
      i) Charitable - 14 cents
      ii) Medical or Moving - 19 cents
   b) Self-employed health insurance, if eligible - Adjustment to Gross Income and a deduction in calculating self-employment income for 2010 only
   c) Health Savings Accounts ($3,050 single/$6,150 family 2010 and 2011)
   d) Child and dependent care expenses (Form 2441) – eligible expenses up to $3,000 per child for the first two children under 13 years of age
   e) Child tax credit for children less than 17 years of age
   f) Education credits
      i) HOPE credit – up to $2,500 per student for first four years per student for 2010
      ii) Lifetime credit – up to $2,000 per taxpayer, indefinitely per taxpayer
   g) Earned income credit

7. Sources of tax information:

Colorado Department of Revenue	Internal Revenue Service
8830 North Union Boulevard	Ogden, Utah 84201
Colorado Springs, Colorado 80920	(800) 829-1040 www.irs.gov
(719) 594-8705	
http://www.colorado.gov/revenue	

The following publications are available free through the Internal Revenue Service local office or web site to assist in understanding the business related tax issues:

- Tax Guide for Small Business (#334)
- Travel, Entertainment, Gift and Car Expenses (#463)
- Business Expenses (#535)
- Self-Employed Retirement Plans (#560)
- Business Use of Your Home (#587)
- Direct Sellers (#911)
- Business Use of Your Car (#917)
- Household Employer's Tax Guide (#926)—Babysitters & Domestic Help

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Forms and information to have handy in preparing your Income Tax Returns:

- Form(s) W-2
- Form(s) 1099-Interest, Dividends, Miscellaneous Income (Mary Kay), Retirement Plan distributions, State refunds, brokerage statements
- Computer print-outs for inventory purchases
- Basis information for purchase of stocks, bonds, or other capital assets including date of purchase
- Automobile registration-ownership taxes paid
- Property tax statement
- Form(s) 1098-Mortgage Interest paid
- Copy of Form HUD-1-Purchase of home or refinance
- Charitable contribution receipts-cash and noncash (Goodwill, DAV & ARC) http://goodwillwm.org/donate/donation-calculator
- A copy of previous year Federal and State Income Tax returns
- Listing of estimated tax payments including amount and date paid

Audit Issues for Schedule C Filers:

- Hobby activity with no profit motive (not a hobby if there is a profit in 3 out 5 five years)
- Unreported income
- Taxpayer not involved in business on a regular & continuous basis
- Personal deductions
- Personal telephone expenses
- Travel expenses of spouses
- Automobile and cell phone record keeping insufficient

Trade or Business versus Hobby:

- Is activity carried on in a business like manner?
- Does the taxpayer have the required 'expertise' in the activity?
- Does the taxpayer devote sufficient time & effort to the activity?
- Has the taxpayer been successful in other business ventures?
- Are there sufficient profits in relation to losses?
- Does the taxpayer rely on the activity for survival and not other significant financial resources?
- Is the activity more business than pleasure or recreation?
- Are there other factors that are indicative of a business versus a hobby?

*The more questions answered as yes, the less likely a hobby exists.

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Tax Information for year ending 2010

Konchar Court Case:

A woman who sold **Mary Kay** cosmetics as an independent beauty consultant was determined not to have operated her business with an actual and honest profit motive. As a result, her claimed business deductions for travel and entertainment expenses were disallowed, as were net business losses ranging from $9,000 to $21,000 per year over three years. The factors leading to the conclusion that the taxpayer lacked an honest profit motive were:

- Failure to maintain business records other than a mileage log for the travel expenses claimed;
- Failure to realize a gross profit or recognize the significance of gross profit for operating a profitable business (her cost of goods sold and returns exceeded gross receipts);
- The significant pleasure component for the taxpayer in traveling to distant states to visit her 12 customers, all of whom were family and friends or were conveniently near family and friends;
- The taxpayer's lack of business experience and failure to consult anyone experienced in cosmetics direct selling prior to embarking on the distributorship;
- The lack of indication of any way to recover the early losses the taxpayer sustained in the business; and
- The fact that the taxpayer's family had substantial income from other sources, enabling her to use the business losses to shelter other taxable income.

Record retention:

- Keep Copy C of all Forms W-2, your Forms 1099 showing interest and other income, and a record of any other information you filed with your return.
- Keep these records for at least 3 years from the date your return was due or filed, or 2 years from the date you paid the tax, whichever is later.
- Normally, tax records should be kept for three years, but some documents — records relating to a home purchase or sale, stock transactions, IRA and business or rental property — should be kept longer.
- For more information, get Publication 552 , Record keeping for Individuals

Clothing:

- Must be a type specifically required (as a condition of employment) by the business, **and**
- Must **not** be adaptable to general or continued usage to the extent that it takes the place of ordinary clothing, **and**
- It must not be worn in lieu of ordinary clothing.

Hair Care and Manicures are considered personal expenses and are **not** deductible business expenses.

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Classification	Type(s) of item(s)
Advertising	Sales List, Preferred Customer Program, Advertising (school bulletins, newspaper, website) Greeting Cards, Business Checks, Business Card
Automobile	Gasoline, oil changes, repairs & maintenance, tolls, parking, taxes, insurance, lease expense
Dues & Publications	Trade dues, membership fees, magazines
Commissions & Fees	Dovetail fees and Unit Prizes/Commissions
Home Office Expense	Mortgage Interest, Taxes, Repairs & Maintenance, Homeowners fees, Utilities, Insurance
Insurance	Inventory, Product Replacement, Liability
Interest	Credit Card, Inventory Loan Interest, Auto Loan
Office	Stationery, Postage, Pens, Paper, Printing, Etc.
Rent	Office Equipment (Fax, copier), Office Space
Repairs and Maintenance	Office Equipment
Supplies	Sales Aids, Section 2, Class Supplies & Initial Beauty Case
Travel Expense	Airfare, hotels, taxi fares, tips, laundry
Wages	Assistant, Spouse, Children, Delivery person
Other Expenses	Accounting & Tax Preparation fees, Bank Fees (merchant fees, Money orders, cashiers checks), Freight & Shipping, Hostess gifts, Laundry (Beauty coat), Obsolete or Spoiled Inventory, Preferred Customer Premiums, Seminar and training meeting expenses, Telephone (long distance and cellular charges), Uniforms, Unrecovered Sales Tax (Section 1 demonstrators, hostess gifts & other giveaways)

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1. All gross retail sales income from beauty appointments and reorders (without sales tax) $ ________
   Discounts & hostess credits from gross retail sales $ ________
   Product refunds/returns at retail value $ ________
2. All other income (4-13% checks, and other prizes and commissions from 1099 MISC form) $ ________
3. Inventory carryover from prior year at cost (as of Dec. 31) $ ________
   Section 1 wholesale purchases for the year without sales tax at cost (on computer sheets from the company) $ ________
   Section 1:
   - Obsolete products (discarded) at cost $ ________
   - Products used for personal use at cost $ ________
   - Products used for demonstration purposes at cost $ ________
   - Items used as promotional items at cost $ ________
   - Ending Inventory (Section 1 Only at Dec 31) $ ________
4. Business Expenses
   Accounting $ ________
   Advertising:
   - Marketing $ ________
   - Preferred Customer Enrollment & Premium fees $ ________

   Auto Expense (business vehicle only)
   - Repairs & maintenance $ ________
   - Gasoline expense $ ________
   - Insurance $ ________
   - Interest $ ________
   - Parking & tolls $ ________
   - Ownership taxes $ ________
   - Total miles driven ____________
     - Business mileage____________ Personal mileage______________

   Contract labor (assistant) $ ________
   Equipment & Furniture (detail each purchase by date description and cost)

Date	Description	
		$
		$
		$

   Freight charges on product orders $ ________
   Product replacement insurance $ ________
   Interest paid on business loans or credit cards for inventory & expenses $ ________
   Legal & professional $ ________
   Office expenses (paper, print cartridges, pencils, pens, etc) $ ________
   Business supplies (includes magazines and publications) $ ________
   Postage & Express mail $ ________
   Bank service charges $ ________

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Promotions & contest expense (do not include Section 1)	$ ______
Laundry for dry cleaning of business attire	$ ______
Meeting expenses, workshops, conferences and seminars	$ ______
Unrecovered sales tax on promotional items, demos & discounts	$ ______
Cost of Director suit or Red Jacket	$ ______
Section 2 business supplies without sales tax (on computer sheets from the company)	$ ______
Starter kit cost if you are a new consultant during the year	$ ______
Travel expense:	
Plane, public transit, taxi	$ ______
Lodging & hotels	$ ______
Entertainment & Meals (interviews, luncheon meetings, and meals while traveling	$ ______
Home Office Expense (for portion of year used as a home office)	
Residential Rent	$ ______
Utilities:	
Electric	$ ______
Gas	$ ______
Water	$ ______
Trash	$ ______
Repairs & Maintenance	$ ______
Homeowner Insurance	$ ______
Home Association dues	$ ______
Telephone	
2nd line (include voice mail, Voice-Tel, and long distance, etc)	$ ______
Cell phone (business use only)	$ ______
Medical:	
Insurance (if not covered by employer plan)	$ ______
Mileage ____________	
Charity donations:	
Cash	$ ______
Noncash (provide date and description; clothing, books, etc)	

Date	Description	
		$ ______
		$ ______
		$ ______

Mileage ____________

Sales Tax Rate charged by Mary Kay __________

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Income Tax Deductions Made Easy

I was audited one year, and the IRS agent said that my records were excellent, so we know these tips work. Your income tax records can be completed in just a few minutes at the end of the year using these ideas and the Income Tax Preparation Sheet.

1. **Use a consultant order sheet to take inventory of your product inventory (Section 1) as of December 31.** Be sure to count products ordered, but not yet received at the end of the year, and product loaned to another consultant. Having a big stock at the end of the year is good for tax purposes. Count all the cleansing creams together and record on the order sheet, the same for each other group of products, no matter what the color or formula. This makes counting fast, and is something you can delegate out for someone else to do. Figure the retail value of the products using the Summary portion of your order sheet, then figure the discount at which you purchase your products. That figure is the wholesale value of the products on your shelves that you will record.
2. **Use a consultant order form to record the products you will use for your personal use.** Add them up at the end of the year as above, and also figure non-collected sales tax on the retail amount that you can use as a tax deduction.
3. **Purchase 12 large manila envelopes and label one for each month of the year.** Place all your income and expense records for each month of the year, such as statements and receipts, weekly accomplishments, sales tickets and computer printouts you receive with your orders in the envelope for that month. Also include cancelled checks or bank statements for that month from your Mary Kay bank account, and your business charge card statement to document your charged expenses.
4. **During the year write up all products used as gift items on sales tickets**. Record the retail amount and amount at cost on the ticket. Keep track of the non-collected sales tax (the amount you prepaid in tax on those products). You can record gifts and non-collected sales tax as part of your Weekly Accomplishment sheet each week, and place the sales tickets in your large manila monthly records envelope as backup records.
5. **Keep the computer sheets you receive with your product orders.** They are records of your product purchases during the year, as well as section 2 and sales tax paid.
6. **Use the bank ledger in your Career Essentials materials to keep track of your business expenses.** Add in your cash expenses at the end of each month. At the end of the year, all you have to do is put the numbers in the correct categories and add them up.
7. **Keep track of all hostess credits and customer discounts.** It is a good idea to charge sales tax on the full retail value of their order, since you already paid the tax on those products when you ordered them.
8. **Carry some petty cash with you from your profits for those items you don't want to pay for by checks from your MK account.** Record cash expenses in your date book right away, and transfer to your business ledger at the end of the month. Example, lunch with your team member. Record the amount, reason for the lunch and who it was with, so you have a record to back up your expense. Cash expenditures can add up, so keep track.
9. **At the end of the year, record your ending odometer reading from your car,** and place your mileage log and car expenses log with your other records for the year.
10. **Use the Income Tax Preparation sheet** which appears in your January newsletter for compiling numbers for your income tax accountant. With the backup records, you're all set.

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Homesale rules liberalized. The IRS has issued new regulations liberalizing key aspects of the homesale exclusion. This exclusion allows an individual to treat as tax-free up to $250,000 of gain from the sale of a home owned and used by him as a principal residence (his main home) for at least 2 of the 5 years before the sale. The full exclusion doesn't apply if, within the 2-year period ending on the sale date, there was another home sale by the taxpayer to which the exclusion applied. Married individuals filing jointly for the year of sale may exclude up to $500,000 of home-sale gain if they meet a number of conditions.

The new regulations liberalize two important rules:

> ... The IRS originally took the position that if a principal residence consistently was used in part for residential purposes and in part for business purposes, only the gain allocable to the residential portion could be excluded. The new IRS regulations adopt a more liberal rule. They provide that all of the gain from the home sale (except for gain resulting from certain depreciation deductions) is eligible for the exclusion if both the residential and non-residential portions of the home are within the same dwelling unit (e.g., one room in the home used as the office of a sideline business). However, gain is allocated if the non-residence portion of the home is separate from the dwelling unit (e.g., an office in a converted garage).
>
> ... An individual may claim a partial homesale exclusion if he (1) doesn't qualify for the 2-out-of-5-year ownership and use rule, or (2) previously sold another home within two years. The failure to meet either rule must result from the home being sold because of a change of place of employment, health, or to the extent provided by IRS regulations, other unforeseen circumstances. The new IRS regulations interpret these conditions liberally. For example, the health condition would be met if a person sells his home and moves cross-country to care for an ailing parent. The term "unforeseen circumstances" is defined as the occurrence of an event that the individual didn't anticipate before buying and moving into the home, and includes divorce or legal separation, the birth of twins, and change in employment or self-employment status that results in inability to pay housing costs and reasonable basic living expenses.

The new IRS homesale exclusion regulations generally apply to sales after December 23, 2002, but taxpayers may elect to apply them to sales after May 6, 1997, and before December 24, 2002. This election may create a refund opportunity for some home sellers.

Finally, as Judge Learned Hand wrote in a landmark case in 1934:
"Anyone may so arrange his affairs that his taxes shall be as low as possible. He is not bound to choose that path which will best pay the Treasury. There is not even a patriotic duty to increase one's taxes. . ."

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