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Dear Mary Kay Beauty Consultants:

First, allow me to congratulate and commend you on starting and operating your very own business. I know that Mary Kay's mission is to enrich women's lives by offering quality products to consumers and financial opportunities to its independent sales force. The tremendous success of Mary Kay is based upon the positive values of integrity, enthusiasm, praise, leadership, quality, teamwork, service, and balance. As a provider of professional services, I strive to embody these positive values in my career as well. My goal is to provide timely, quality service with integrity to all of my clients, and my success is built upon helping you grow your business profitably.

The purpose of this Guide to Business Taxes for Mary Kay beauty consultants is to provide general tax information to help you understand the preparation of your income tax returns as they relate to your Mary Kay business. Please use this guide as a learning tool and a helpful reference to answer many frequently asked questions. The most important tax issue for you to understand is that as a Mary Kay independent beauty consultant or independent sales director, you are the sole proprietor of a business and are considered to be a self-employed independent contractor for tax purposes. In this role, you may be liable for federal, state, local and self-employment taxes on the net income from your business. Therefore, it is critical that you understand the business deductions that are available to you, and the importance of keeping thorough and accurate records.

Although this guide is designed to answer many of your tax-related questions, I am available to meet with you personally or answer additional questions you may have by phone or by e-mail, and will be pleased to do so. My initial consultation with you is free, and is my investment of time in our future working relationship. You have my best wishes for a prosperous and fulfilling business.

Very truly yours,

Mark J. Milslagle, CPA/ABV

Tax Reporting Status

Although there are many unique features to running a Mary Kay business, your tax reporting status with Mary Kay is not unique. Most outside salespersons are treated as "Independent Contractors", or as "Self-Employed" individuals. Such individuals are treated differently for tax purposes than employees who receive W-2's for their wages. The most important differences involved in being self-employed are the assessment of self-employment taxes on the net income of your business, and the deductibility of business expenses. As a beauty consultant, you are required to report your business income and expenses on Schedule C, "Profit or Loss From Business" attached to your Form 1040 (U. S. Individual Income Tax Return). The net profit or loss (after expenses) calculated on Schedule C is carried to the first page of your 1040 and combined with your other income (and the income of your spouse if you are married and filing a joint return).

One key IRS issue to be aware of is the "Hobby Loss" rule. If your Mary Kay venture does not report a profit in three out of five consecutive tax years, and you used losses to offset other income, the IRS may make the determination you were not engaged in this to make a profit and this activity was merely a "hobby". They may then limit the deductions to offset the Mary Kay income you made, require amended returns from you, and assess penalties and interest for the proper reporting of your taxes.

Taxes Assessed on Net Income from Mary Kay Business

If your Mary Kay business results in a net profit for the year (as reflected on Schedule C), this profit will add to your taxable income for the year and will, therefore, be subject to Federal and State income taxes. The net profit may also be subject to local income taxes, depending on where you live and conduct your business. As a Mary Kay consultant, your net profit is also subject to self-employment tax, in addition to your regular income tax. For example, if your gross income for the year is $22,500, and your total expenses are $11,000, your net income would be $11,500. This net income of $11,500 would be subject to all forms of income tax and self-employment tax.

The self-employment tax actually provides Social Security and Medicare benefits for you upon attaining the eligible age for benefits. Self-employment tax totals 15.30%. Those who are employed and receive W-2's for their wages have 7.65% of their pay withheld by their employer for Social Security and Medicare taxes. The employer then matches this 7.65% and pays the entire 15.30% to the federal government. As a self-employed Mary Kay consultant, you are liable for the entire 15.30%. However, please remember that you only pay self-employment tax on the net income from your business, not on your gross business income.

Tax Return Due Dates

The Form 1040 – U. S. Individual Income Tax Return is due by April 15th, unless the 15th falls on a weekend or a federal holiday, in which case the return is due the following business day. If more time is needed, you can file for an automatic six-month extension of time through October 15th. This is not an extension of time to pay any additional taxes due, however. Under no circumstances, should you file a return after October 15th. After that date, the return is delinquent and will be assessed further penalties and interest if taxes are due at that time.

Inventory

The most important fact to remember about inventory is that your inventory is not a business deduction until it is sold. You must count the inventory that you have on hand at December 31st each year. Remember to value your counted inventory at your cost in the product; do not report the value of your inventory at its suggested retail value. On your Schedule C, you will receive a deduction for the cost of the inventory that you actually sold during the year. This deduction is known as cost of goods sold. Also, you must track the amount of product used for personal use, since this amount will not result in a deduction.

Income to be Reported

When you begin your Mary Kay business, the majority of your income will result from personal sales, but as you progress in your business, income may come from a number of sources, including the following:

- Personal sales (skin care classes, facials, and private makeover sessions)
- Reorders and the Preferred Customer Program
- Recruiter and Sales Director commissions and bonuses
- Company awards, incentives and prizes
- Car program

In order to accurately report all sources of income received, I strongly recommend that you keep all sales tickets, the Form 1099 (Miscellaneous Income) received from Mary Kay, and the Mary Kay Income Advisory Statement. Also keep your monthly consultant statements, bank deposit slips and bank statements. I also highly recommend you keep a separate bank account for your Mary Kay business, and if you use a credit card for business purposes, do not use this same card for personal reasons.

Expenses to be Deducted

As an independent businessperson, you are allowed to deduct all necessary and ordinary business expenses of reasonable amounts that are paid during the tax year (except for the cost of your unsold inventory on hand at year-end as explained above). The following listing will assist you in determining which expenses you incur will be deductible to offset your business income.

- **Advertising:** Section 2 purchases, preferred customer plan, business cards, posters, booths, name lists, print ads (newspaper, phone listing, school boosters)

- **Bad debts:** A returned check or refused credit card payment, but only deductible if the sale is already included in income

- **Commissions and prizes:** Amounts paid or prizes given to other consultants or team members. This includes dovetailing commissions that you pay, and cash bonuses paid by a Sales Director.

- **Depreciation:** Depreciation may be claimed on automobiles used for business (if using the actual expense method to deduct auto expenses), office furniture and office equipment including computer equipment and software, and on the portion of your home that is used for business

- **Insurance:** Product replacement and business liability (not health insurance)

- **Interest:** Interest paid on a bank loan or credit card if the nature of the account is for business only

- **Professional services:** Any payments to accountants, lawyers, or other professionals for services related to your Mary Kay business

- **Office expenses:** Paper, pens, day planner, postage, shipping costs, stationery, printer cartridges, toner, file folders, some software

- **Pension plan:** Contributions to a pension plan, such as a Simplified Employee Pension, or a SIMPLE IRA, may decrease tax on your ordinary income

- **Rent or lease:** Meeting rooms, equipment rentals (postage meter, fax, copier, computer, furniture, phone system), office space, and the business use portion of automobile lease expenses, if using the actual expense method for car expenses

- **Repairs:** Repairing business equipment (copier, computer, fax)

- **Supplies:** Sales aids (cotton balls, swabs, bags, mirrors, paper plates), starter kits

- **Taxes and licenses:** Local business licenses and local taxes paid related to your Mary Kay business (do not include federal and state income taxes)

- **Travel:** Air fare, hotel room, rental car, taxi or shuttle fares, parking, tips

- **Meals & entertainment:** Breakfast, lunch or dinner meetings, food while traveling and entertaining. The allowable deduction is only 50% of the total cost incurred.

- **Utilities:** Related to rented office space, or utilities for home office expenses (see below)

- **Wages:** Do not pay yourself a salary, only your office assistants or other employees. Self-employed individuals take draws for their living expenses, not salaries.

- **Telephone & cell phones:** Second line, long distance, calling features on home phone, and business use percentage of cell phone

- **Internet:** Business use percentage of monthly service charge

- **Dry cleaning:** Mary Kay jackets, logo clothing, or incurred while traveling

- **Bank & credit card fees:** Mary Kay bank account, credit card processing fees (on sales)

- **Dues & subscriptions:** Magazines, professional groups, chamber of commerce, networking groups

- **Uniform:** Mary Kay jackets, logo clothing, special occasion gowns

- **Business gifts:** Individual gifts no more than $25 each

Recordkeeping tip: As a general rule, keep all receipts for business expenditures. The IRS requires that you maintain receipts for all individual expenses of $75 or more.

Further expenses may be claimed for the use of your automobile or a Mary Kay automobile for business purposes, and for home office expenses. These expenses are discussed in detail below.

Automobile Expenses

The two available methods for figuring the deductible amount of car expenses are the actual expense method and the standard mileage method. Both methods require an accurate record of business miles driven. If you drive a Mary Kay career car, whichever method you decide to use must be used consistently throughout the period you drive that particular car. You will not be able to change your method of computing the car deduction until you take delivery of a new career car. If you own your vehicle, you may switch between the two methods in different years, but only if you used the standard mileage rate the first year.

Under the standard mileage rate method, your deduction will equal your total business miles driven multiplied by 48.5 cents per mile for January 1, 2005, through August 31, 2005, and 44.5 cents per mile for September 1, 2005, through December 31, 2005. While this rate may not sound like much, every 1,000 business miles driven will yield a deduction of approximately $485. Many Mary Kay consultants drive several thousand business miles per year. If using the standard mileage rate method, you may still deduct personal property taxes paid on your vehicle, and any parking fees or tolls you pay while using the car for business purposes.

If you choose the actual expense method, you must still keep an accurate record of business miles driven and of total miles driven. You will then be able to deduct the business use percentage of all actual expenses for operating the vehicle, including depreciation. For example, if you drive your car 12,000 total miles during the year, and 6,000 of those miles are for business purposes, your business use percentage would be 50%. If your total actual expenses for the year were $5,000, your business deduction would equal $2,500.

Actual car expenses that may be deducted include the following:

- Gasoline & oil changes
- Repairs & maintenance (also includes items such as new tires, car washes, new battery)
- Automobile insurance
- Property tax (paid annually to the county clerk)
- Interest on car loan (only if you own the vehicle)
- Auto club (Triple A)
- Depreciation (if business use percentage equals 50% or more)

If you have earned the use of a Mary Kay career car, you may use either the actual expense method or the standard mileage rate method to deduct your business expenses related to your car. Whichever method you choose must be used consistently throughout the time you drive that particular car because it is a leased vehicle. The lease value of your career car is reported as income to you by Mary Kay and must be included as income on your Schedule C.

Home Office Expenses

Because Mary Kay consultants have no actual office in which to store inventory, maintain customer records and perform their bookkeeping, the regulations allow you to deduct a portion of certain home expenses in certain cases. In order to claim this deduction, a portion of your home must be used exclusively and regularly for your business. This area could include office space and inventory storage space in separate areas of your home. Once this area has been established, home office deductions may be taken on the allocable portion of the home used for business. This portion is typically calculated as a percentage of the total square footage of the home used for business purposes.

There are limitations to the amount you may claim as a home office deduction, and the use of this deduction can only reduce net income from your Mary Kay business to zero; it cannot create a net loss. Any unused portion is carried forward to future years. The home office deduction includes expenses that are directly related to the home office space itself (direct expenses are 100% deductible), and also includes expenses that are related to the entire home (indirect expenses are deductible only to the extent of the business use percentage of the home). A listing of home expenses includes the following:

- **Home mortgage interest:** The business use percentage is deductible, and the remaining amount is carried over to Schedule A as an itemized deduction

- **Real estate taxes:** The business use percentage is deductible, and the remaining amount is carried over to Schedule A as an itemized deduction

- **Homeowners insurance:** An indirect expense, only the business use percentage is deductible

- **Repairs & maintenance:** Includes interior and exterior such as plumbing, painting, electrical work, etc. If the expense is directly related to the home office, such as carpeting, remodeling, shelving, etc., the expense is 100% deductible.

- **Utilities:** An indirect expense, the business use percentage of gas, electric and water is deductible

- **Rent:** Those who rent homes or apartments may claim the business use percentage of their rent expense

- **Non-deductible expenses:** Lawn services, swimming pools, hot tubs and other expenses not needed for the conduct of a business are not included in the classification of home office expenses

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Experience: With over fifteen years public accounting experience with regional accounting firms, Mr. Milslagle has served a wide range of clients within the following industries: retail, wholesale, manufacturing, restaurant, service professions, construction, investment, private colleges, pension plans, nonprofit and governmental. He has also managed other engagements including business valuations, litigation support, business plans, business forecasts and projections, financial analysis, and accounting research.

Professional And Community Activities:

Member, American Institute of Certified Public Accountants

Member, Kentucky Society of Certified Public Accountants

Member, Oral Roberts University Alumni Association

Member, Blue Grass Estate Planning Council

Former President, A. A. Pregnancy Help Center

Former President, Bluegrass Christian Adoption Services

Coach, Southeast Lexington Cal Ripken Baseball League

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