

## **Is “Autoship” a Tax-Deductible Business Expense?**

**First, understand this:** The U.S. Tax Code is not clear on the issue of deductibility of “autoship,” and Federal Tax Courts have yet to issue a ruling on it. Thus, what follows is simply a *professional opinion* of one individual tax expert -- *not an answer* to the question. The reader is strongly advised to discuss this issue with his/her tax professional prior to making a determination.

**IMPORTANT BACKGROUND:** When a taxpayer seeks ‘official guidance’ on the legality of deducting any business expense, if the Tax Code is not clear, and if the IRS has not issued a clarification of any kind, and if there have been no rulings on the subject by any federal tax court, the Courts have said that, under these circumstances, the *taxpayer should use his or her best judgment, and IF an auditor should later disallow the deduction, the taxpayer cannot be assessed any penalties* (other than paying taxes and back-interest on the amount of the disallowed deduction) *for having claimed the deduction.*

For purposes of this report, **we will define the term *autoship*** as “the dollar-value of products or services a Network Marketing (MLM) company requires all independent marketing representatives (distributors) to purchase on a monthly basis in order to qualify to earn and receive maximum commissions, bonuses, and/or other compensation under its pay plan.”

If a distributor (a) is engaged in the marketing of a company’s products or services on a regular and consistent basis, (b) can prove they have a profit-intent, and (c) keeps accurate and complete business records, most likely their efforts would be considered to constitute a legitimate Home Based Business – thus, they are considered to be Business Owners.

**BUSINESS OWNERS** are authorized by the U.S. Tax Code to claim, as “Miscellaneous Deductions,” expenses which are “***Ordinary and Necessary***” – *Ordinary* in their industry or business category, and *Necessary* to their business success. One might conclude that autoship is an *Ordinary* expense, because it is more common than uncommon for companies in the MLM industry to place this requirement on its distributors, and one might conclude that autoship is a *Necessary* expense, because if you do not pay it, you cannot maximize your pay plan, thus restricting your profit potential.

**SO, IS IT DEDUCTIBLE OR NON-DEDUCTIBLE?** Does the above mean your autoship cost would be tax-deductible? Maybe, but you must consider also the fact that you do receive either products or services for your autoship expense. So, perhaps the answer lies not in whether autoship is deductible, but in how much of the autoship cost you deduct. Here’s a fresh (and I believe realistic) way of looking at it.

Perhaps you do not claim 100% of the autoship cost, but perhaps you *do* claim *most* of it. Here is the rationale... Obviously, the company incurs a considerable expense for (a) providing drop-ship delivery

service for you and your customers, (b) staffing a customer service department for you and your customers, (c) providing regular training calls for your continuing education and success, (d) sponsoring business opportunity meetings to assist you in growing your organization, (e) providing a secure web site back-office to assist you in administering your business and your team, (f) providing experts to answer questions for you and your customers, (g) providing on-call technical assistance for any web site issues, (h) processing commission checks for you and your downline, (i) continually creating new marketing tools to assist you in building a strong business, *etc., etc., etc.*

**WHO PAYS FOR ALL OF THAT?** Since the company doesn't charge you *directly* for any of those business services they provide for you, who pays for them? *The expense must be built into the product cost.* This is why network marketing companies require you to be on autoship. *Somebody* has to pay for these valuable services, so if they build those costs into the price of the products, and then require all distributors to purchase them on a regular basis, it spreads out the costs evenly.

Since items (a) through (i) in the above list would meet the IRS definition of "Ordinary and Necessary Business Expenses" they would be tax-deductible if you paid for them separately.

**SO, HOW MUCH WOULD BE TAX-DEDUCTIBLE?** The question, then, is how much of the product cost is actually paying for all of these "Ordinary and Necessary" business expenses, versus the cost of the product itself?

The answer is subjective, and surely varies from company to company, but at least one tax pro suggests that 85% of the cost of any MLM's product is to pay for services that are "ordinary and necessary" for you to run a successful business, and the remaining 15% is for the cost of the product or service itself.

**WHAT IF YOU ARE AUDITED?** In the event of an audit, any dispute with the auditor would center around the percentage you claimed as business expenses, not over whether the total autoship amount is or is not deductible. And by claiming only a *percentage* of the product cost, not the entire amount, you will have shown a "good faith" effort in being IRS compliant. That means, even if the entire deduction is disallowed (although that's not likely) they cannot stick you with penalties, as explained on the previous page. So the worst that can happen is that you'll have to pay back the taxes which you saved by taking the deductions – which is exactly what you WILL pay *for certain* if you don't even *attempt* to claim the deductions.

**WILL YOUR TAX PRO AGREE?** The IRS is holding tax preparers more and more accountable for the "correctness" of the tax returns they prepare. With their signature on your tax return, he or she is stating says that "there is a reasonable belief that the tax treatment of the position would more likely than not be sustained on its merits." English translation: They think that a tax court would agree with all the deductions claimed on your tax return.

If you have an extremely conservative tax pro, you may be required to provide a "CYA" statement, stating something like, "Despite your recommendation to the contrary, I insist that 85% (or whatever amount you are comfortable with) of my autoship expenses be included as "Miscellaneous Ordinary and Necessary Business Expenses." He'll put that signed directive in his files in case he ever needs it to "C" his or her "A." Bottom line: If you do not claim the deduction, you will lose it. If you do claim the deduction, you may (although it's unlikely) lose it. Use your own judgment.