

Key Issues in Starting your Network Marketing Business

## NETWORK MARKETING

# KEY ISSUES IN STARTING YOUR NETWORK MARKETING BUSINESS

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## Introduction

This paper discusses the general practical aspects of starting your Network Marketing Business ('NMB') in New Zealand only. This is a general discussion and focuses on:

1. The definition of a business?
2. Is your activity a NMB activity?
3. General income tax implications of a Network Marketing Business.
4. Record keeping.
5. Starting a business - checklist

If you want specific advice regarding your NMB, please contact your advisor or myself (my contact details are below).

This paper includes a general discussion on income tax as it applies to taxable income and allowable deductions only.

It is not intended for the purposes of tax planning - its main aim is to assist you with your NMB.

## About the author, Stephen Diedericks

Stephen came to New Zealand from South Africa via Australia. He has a Bachelor of Commerce and is a Certified Practising Accountant. He has been enrolled as a Barrister and Solicitor of the High Court of New Zealand and a solicitor of the Supreme Court of New South Wales, Australia.

Stephen has over 20 year's commercial experience, nine of those working with the world's two largest accounting firms.

Stephen lives in Auckland and when he is not working he loves spending time with his wife and five children. They are keen bushwalkers.

## 1. Definition of Business

The definition of business is broad and in general any activity that occurs on a regular basis may be regarded as a business, whether there is an intention to make a profit or not. A network marketing business is a business. We will focus on the practical aspects of your activity in your NMB. This is because your *activity* will determine whether or not you are in business.

The definition of business is important because:

1. the commissions derived by you from your NMB is income and therefore taxable; and
2. you may be allowed a tax deduction for the amount of expenditure or loss you incurred in the course of carrying on your NMB.

For example, you regularly attend events, together with your guests, who subsequently order products.

If you are carrying on a business (rather than a hobby), the commissions received from the sales of products will be income to you and taxable to you. In addition, you will be entitled to claim tax deductions for the expenses incurred in operating that business and generating the taxable income.

However, if your activities were simply carrying on a hobby and not a business, the commissions from the sale of products would not be income. You would not be able to claim tax deductions for the expenses incurred generating the commissions.

## 2. Is your activity a NMB Activity

To determine what constitutes business activity, you must consider:

1. the nature of the activity carried on (not hobby); and your intention to engage in those activities.
2. The question to ask is whether there is an intention to carry on a business for profit. The existence of a genuine intention to carry on a NMB for profit is enough. However, a claimed intention may be viewed with scepticism if, on an objective examination of the realities at the time, it appeared that, even in the longer term, a profitable outcome was impossible or highly unlikely.

A business can exist even though a profit may not be derived for years. The following factors will indicate whether you intend to make a profit:

1. the nature of the activity;
2. the period over which the activity was engaged in;
3. the scale of operations and the volume of transactions;
4. the commitment of time, money, and effort;
5. the pattern of activity; and
6. whether the activity is of the same kind and carried on in the same manner as would be characteristic of ordinary trade in the network marketing industry.

In order to evaluate the extent of a person's operations, Inland Revenue may request details of development plans and budgets on income and expenditure. These will give an indication of the manner in which the activity is to be carried on and whether there is the necessary intention to make a profit. You must show that the plans have been carried into practical effect.

You may deviate from the stated plan or budget for very good commercial reasons or due to factors outside your control that were not anticipated at the time the plan or budget was made. It is the character and circumstances of your actions that are crucial to determining whether you are in business or not.

For example, write down your why, share it with your Upline (who will also write it down) and with your downline, write down your goals, plan of action, such as becoming a Senior Executive Marketing Director by 31 December 2016. Your plan should include details of how to reach that goal, such as becoming Regional Marketing Director and Executive Marketing Director. Your budget would include the price of the products (including the increased amount of products to make the qualifying volume), costs of telephone calls making invitations and follow ups and training calls etc.

Travelling costs to events, including national and international events.

A business is also characterised by some repetition of activity or continuity of effort. In this regard, factors indicating the presence of a business includes the volume of transactions, the period over which the activity is engaged and the pattern of activity. If your activity is sporadic (for example, making invitations) then your actions may be regarded as a hobby and not a business.

There are various business structures that can be used in your NMB. You should seek advice from your professional advisor as to the most appropriate structure.

### **3. General income tax implications of a Network Marketing Business**

The distinction between an activity that is carried on as a business and one that constitutes a hobby is important for income tax purposes. Income tax is payable on income derived from a business whereas any profits or proceeds from a hobby will generally not be subject to tax. Similarly, expenditure or losses incurred by a business are tax deductible, however, expenses or losses incurred by an undertaking in the nature of a hobby will generally not be tax deductible.

The actual time a business commences will ultimately depend on the particular facts in a situation. It is possible for a business to have commenced even though no income has been derived. A business ordinarily commences with the beginning of the current operations, which may vary depending on the nature of the business involved.

In your NMB, when a new prospect signs up to the business and purchases their products, set a time to attend the training, attends the training, writes down their why, goals, action steps, starts taking action (i.e., makes invitations), they are more likely than not in business. The purchase of their initial products will be tax deductible to them. It is not important that they sign someone up immediately or make an immediate profit. What is important is the action taken by the new prospect and that their action is repetitive and their intention is to make a profit.

*Listed below are a series of practical questions and answers as they apply to a NMB and income tax.*

### **Question: What is your business income?**

Answer:

In your NMB your income will come from commissions received from the company you have aligned with. That is, someone you introduced to the company and its products orders products from the company. In return, the company pays you a commission. The commissioner is taxable income.

In your NMB, you will also attend events such as national and international conferences. You may set a goal with your team to meet a certain goal by the date of the conference. For example, you will reach Senior Executive Marketing Director by the date of the conference. As an incentive, your Upline provides that they will pay your airfare if you reach your goal. When you reach your goal and the airfare is paid, the price if the airfare is taxable income to you and it is tax deductible to your Upline.

### **Question: What are business expenses?**

Answer:

Expenses incurred in running your NMB are separated into revenue and capital expenses. Revenue expenses include product purchases to qualify for different ranks to earn commissions, advertising expenses, telephone expenses for calling prospects, 3-way calls, travel expenses, business meeting expenses (e.g., venue hire), pens, note pads and banners, etc. Capital expenses include asset purchases such as mobile phones, laptops and motor vehicles.

Generally, you will claim your revenue expenses in the year you incur them, while you will depreciate capital expenses over time.

To claim an expense, you must have a record of that expense, e.g., a receipt, or you may not be allowed to claim that expense. Detailed below is information on record keeping.

#### *Specific business expenses*

##### **Entertainment expenses**

What are they?

Answer: Lunches and dinners

Some business entertainment expenses are fully deductible while others are only 50% deductible. You need to keep receipts and a record of the reason for the entertainment.

##### **Travel and accommodation**

You will spend time travelling as part of your business. You can claim a portion of these expenses as a tax deduction. A good way to keep track of your travel expenses is by keeping a diary of your travel. You need to keep receipts and a record of the reason for the travel. Inland Revenue is likely to ask for them.

Some entertainment or pleasure may be taken during what is predominantly a business trip. For example, you go to Australia to provide training to your downline and a presentation at an information evening. These events just happen to coincide with an international rugby match between Australia and New Zealand. Unfortunately, you have to stay another day to attend the match. Your whole trip will still be fully tax deductible, including your accommodation and meals etc. for the extra day (except the costs of the rugby tickets).

### Home office expenses

If you use an area of your home for your business, you can claim as a tax deduction a portion of the household expenses such as:

- rates;
- power;
- house and contents insurance;
- mortgage interest (if you own the home); or
- rent (if you are renting the home).

You must keep invoices for these expenses.

If you are not using a separate area of your home for your business, you'll need to take into account the amount of time spent on your business activities and the area used. The business percentage of your home office expenses can be claimed as a deduction for income tax.

If you're GST registered, the GST content on your home office expenses can be claimed as they are paid (in each GST return period), or at the end of your tax year. Remember that mortgage interest and rent don't include GST.

### Motor vehicle expenses

Many people use their motor vehicle for business and private use. Different rules apply to the amount of travel you can claim for your vehicle, depending on whether you operate your business as a sole trader, partnership or a company.

#### *Sole trader or partnership*

If you are a sole trader or partnership and you use your own vehicle in the business, you can claim a portion of the expenses you incur for running costs such as:

- petrol;
- repairs;
- tyres;
- car insurance; and
- vehicle registration.

If you use the vehicle strictly for business, you can deduct the full running costs without making any adjustments.

#### There are three ways to claim expenses:

1. Use a log book to identify how much you use your vehicle;
2. Claim a flat rate of 25% of all vehicle expenses; and
3. Claim mileage rates.

#### *1. Use a log book to identify how much you use your vehicle*

To claim expenses for a vehicle used privately and for business you will need to keep a log book for three months.

After three months, work out the number of kilometres you travelled for your business and compare this figure to the total kilometres travelled. This percentage of your motor vehicle expenses you can claim against your income.

You can generally use this percentage for three years before you need to keep another log book again for a further three- month period.

### *2. Claim a flat rate of 25% of all vehicle expenses*

If you do not keep a vehicle logbook, you may claim up to 25% of the vehicle running costs as a business expenses.

You may be asked to substantiate the percentage claimed so you will still need to keep records for your vehicle expenses.

### *3. Claim mileage rates*

If your business travel is less than or equal to 5,000 kilometres for the year, you can work out your deduction for motor vehicle expenses using the Inland Revenue or Automobile Association's mileage rates.

You still need to keep record of all the kilometres you travel for your business and calculate your deduction based on the current mileage rates.

### *Company*

If you trade as a company, vehicle expenses are calculated differently.

When a company owns a car, a logbook is not required and it can claim all the expenses without making a private use adjustment.

However, the company will be liable for fringe benefits tax (FBT) if the vehicle is available for employees or shareholder-employees private use. The company will also have to calculate GST on the FBT. Some vehicles may meet the exemption criteria.

If the shareholder uses their own vehicle, the company can reimburse the shareholder but if kilometres are over 5,000 they may need to consider whether the mileage rate is still a reasonable calculation of expenditure.

If you are registered for GST, your income tax return will exclude GST on your income and expenses (GST is accounted for in your GST return).

If you're not registered for GST, your income tax return will include GST on your expenses only.

Note: claiming personal expenses as business is committing a fraud and could result in a shortfall penalty being imposed, or possible prosecution action. It is important to show how your expenses link to your business.

## **4. Keeping good business records**

It is vital to keep accurate records. It makes it easier to keep track of your income and expenses and will assist you with budgeting and business decisions. There is also a legal requirement to keep accurate records.

Here are a few basic rules for record keeping:

- keep all records for seven (7) years.
- Electronic records are okay, but please remember to back up your information on a regular basis.
- Keep receipts for all transactions, even those under \$50.00.
- Keep copies of any records that might fade like eftpos receipts (scan them and save them online).
- Staple receipts to an A4 sheet to avoid losing them.
- All records must be in English (unless you have approval from IRD to keep them in different language).
- open bank accounts for your business and another account where you deposit enough money for your tax payments.
- Review your electronic bank accounts and see how you can use them to maintain your records.

## **5. Starting a business – checklist**

The following checklist will be helpful to keep track of what you need to do. Choose from the list the items that will apply to you.

## Key Issues in Starting your Network Marketing Business

### Professional Advice

- Talk to an accountant
- Choose your business structure, e.g., sole trader, partnership, company
- Get help to create a business goal, your why and a plan
- Prepare a cash flow projection, funds to attend events (national and international)
- Set up a business bank account

### Inland Revenue

Register for myIR secure online account

If you are a sole trader, advise IRD when you start your business

Work out if you need to register for GST

### Keeping Records

- Keep a business diary for appointments and important contact details
- Set up a record keeping system and keep all business-related invoices and receipts
- Home office-calculate the area of your home being used for business
- Start a vehicle logbook
- Buy or create an invoice book (or tax book if registering for GST)
- Set up an asset register (depreciation schedule)
- Using your own assets? Get a written valuation of any private assets being introduced to the business.

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