TAX ESSENTIALS
For the Tax Year 2017

TAX ESSENTIALS WAS NOT INTENDED OR WRITTEN TO BE USED, AND IT CANNOT BE USED, FOR THE PURPOSE OF AVOIDING U.S. FEDERAL, STATE OR LOCAL TAX PENALTIES.

TAX ESSENTIALS
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Important Information about Tax Essentials

The Purpose of *Tax Essentials*
Tax Essentials provides general tax information to help you understand the preparation of your federal income tax return as it relates to your Mary Kay business. It will also help you get started with sound record keeping practices for the following year. Whether this is your first year as a Mary Kay Independent Beauty Consultant or your fifteenth, *Tax Essentials* is still an important guide for you to read because you are an independent contractor.

As an independent business person, you know that accurate recordkeeping is an important part of doing business. This guide does not assume that you are a tax expert, and it was not designed to make you one. *Tax Essentials* is designed to show you what records you should keep for your Mary Kay business and then how you can use these records when preparing your tax return. You may find the suggestions offered in this guide helpful as you conduct your independent business. Even if you do not prepare your own tax return, your personal tax advisor can ensure you pay the lowest possible tax if you maintain all the relevant information and proper documentation.

Important Notes
1) It is recommended that the tax guide be used for general informational purposes only. **It is not intended to be and shall not be considered tax advice**.

2) Due to both the complexity of the existing tax laws and the uniqueness of each person's tax situation, the Company recommends that you **do not advise potential or current Independent Beauty Consultants on tax-related matters**. Please refer them to this guide or to their personal tax advisor. There are many variations in each particular situation, and you or your personal tax advisor may choose to take a different approach in some areas.

3) The Company suggests using an accountant or personal tax advisor who is familiar with federal, state and local laws as well as the direct selling industry to advise and assist you in filing your federal and state income tax returns as well as any gross receipts, business and occupation, property or other taxes that you might owe. In addition, Independent Sales Directors who may have international team building activities should rely on a personal tax advisor familiar with international tax matters.

4) On December 22, 2017, the "Tax Cuts and Jobs Act" (P.L, 115-97) was signed into law. Most of the provisions in the law take effect on January 1, 2018. There are however, a few provisions that are retroactive to 2017 and 2016. Please see your personal tax advisor to verify that there were no additional tax law or form changes that could affect you.

How to Use the Tax Guide

Tax Essentials is designed to be used as a learning tool and a reference guide. It can give you a basic understanding of the issues involved in recordkeeping and income tax preparation as it concerns your Mary Kay business. In addition, if you plan to have a tax professional prepare your return for you, it may be a good reference tool for your tax preparer. Your tax preparer will be able to answer any specific questions you may have and may have additional suggestions for you.

A Note about Your Federal Tax Status

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 federal income tax purposes under the Internal Revenue Code Section 162. Tax legislation requires that the Company obtain a valid Social Security number for each Mary Kay Independent Beauty Consultant. The Company is required to withhold federal income tax (backup withholding) on income earned (commissions, prizes and awards) by Independent Beauty Consultants who fail to report their Social Security or Individual Taxpayer Identification Number (ITIN). The federal backup withholding rate for tax year 2017 was 28 percent. The federal backup withholding rate for 2018 is 24 percent. The Internal Revenue Service announced the new backup withholding rate in January 2018 and gave taxpayers until February 15, 2018 to implement the new rate. Mary Kay systems will be updated with the new rate by February 1, 2018. In addition, Independent Beauty Consultants who reside in California and are subject to federal back-up withholding, are also subject to 7 percent California back-up withholding

The law requires the Company to issue a Form 1099-MISC to any Independent Beauty Consultant who, during a calendar year, orders more than $5,000 in wholesale merchandise or receives $600 or more in commissions, prizes or awards. The form will only indicate that $5,000 or more in wholesale merchandise has been ordered, but the exact amount will not be stated.

The Importance of Keeping Accurate Records

Why Recordkeeping is Important
Accurate, up-to-date records are vital to your Mary Kay business. They will help you keep your Mary Kay business organized and may even save you money on your income taxes.

If you do not keep accurate records, you may miss deductions to which you would otherwise be entitled. In the event of an audit, if your records are inaccurate, poorly kept or in disagreement with your tax return, you may have to pay additional taxes, penalty and interest.

Basic Recordkeeping Guidelines
Here are some suggested basic record-keeping guidelines:

1. **Keep your business expenses separate from your personal expenses.** You may want to open a separate checking account for your Mary Kay business and consider obtaining a credit card to use strictly for business expenses. The advantage of doing this is to make your record keeping easier. You will know that all the income deposited into your business account is Mary Kay earnings and all checks written or purchases made using your business credit card are Mary Kay expenses. Keep all monthly statements and deposit slips.

   Use of the words *Mary Kay, Mary Kay Cosmetics* or *MK* on your accounts is not authorized with the exception of those offered through MKConnections®.

2. **Maintain a daily business log.** A daily record of your business activities is critical for supporting various types of business expense deductions you may want to claim. You will want to record details of all appointments and business expenses in this daily log as well as your business mileage. You may want to use your datebook or daily planner as your business log.

3. **Save all Mary Kay business-related documents and records.** Any document or record that supports income or an expense is a supporting document and should be retained. You might want to organize these documents or records in some kind of filing system. The Records Checklist that follows this section provides examples of what records to keep.

4. **Retain all records for a sufficient length of time.** Supporting documents should be kept as long as they may be needed to verify amounts on a tax return, at least four years, perhaps more. Check with your personal tax advisor before throwing out any documents.

Records to Keep Regarding Income

To support information about your income, you'll want to maintain accurate and detailed records, which include, but are not limited to:

Sales tickets - Your copy of the sales ticket is your most detailed source of information regarding personal sales. ***Weekly Accomplishment Sheets are not a substitute for sales tickets as tax documentation.***

Form 1099-MISC - If you order more than $5,000 in wholesale merchandise during the calendar year, or receive $600 or more in commissions, prizes or awards, you will receive a Form 1099-MISC from the Company. More information about Form 1099-MISC can be found in the section discussing Schedule C.

Income Advisory Statement - All Independent Beauty Consultants and Independent Sales Directors who receive either a Form 1099-MISC from the Company or prizes/awards in excess of $200 will receive an Income Advisory Statement. More information on Income Advisory Statements can be found in the section discussing Schedule C.

Monthly Commission Statement - The Monthly Commission Statement is available online. **You should keep a file of these detailed statements as documentation for your Mary Kay income.** More information on Monthly Commission Statements can be found in the section discussing Schedule C.

Bank deposit slips and bank statements – You may want to deposit all Mary Kay income in your business bank account and keep all deposit slips. It is also recommended that you keep your monthly bank statements.

Records to Keep Regarding Expenses

Inventory and Product Sales
To support any deductions regarding inventory and product sales, you should retain copies of the following records or documents:

Independent Beauty Consultant order forms - Keep a copy of each order form you send to the Company for product purchases including Customer Delivery Service (CDS) sales. It is also a good idea to keep printed copies of all Mary Kay online orders.

Packing Slip/Invoice - Each time you receive merchandise from the Company, a packing slip accompanies the order, which details the product you bought as well as the taxes and shipping and handling you paid. You should check this packing slip against your Consultant order form. If merchandise has been back ordered (scheduled for later shipment to you because of unavailability), more than one packing slip will be necessary for you to reconcile the order. You may want to file your packing slips with the corresponding Consultant order form.

Non-Business use records - ***Inventory you withdraw for non-business use is not deductible.***

A good way to keep tabs on non-business use is to use a Consultant order form clearly marked “Non-business Use” to record items withdrawn. Keep these forms to substantiate non-business use for your tax return.

Copies of money orders, cashier’s checks, credit card receipts for product purchased - It is important to keep copies of your money orders, cashier’s checks and credit card statements to support inventory purchases.

Inventory counts – For tax purposes, you should count your inventory on or as near as possible to December 31. More information about inventory can be found in the section discussing Schedule C, Part III, Cost of Goods Sold.

Record of product given as hostess gifts - Keep a record of the cost to you of Mary Kay® products you give as hostess gifts or as gifts-with-purchase under the Preferred Customer Program. A good way to keep track is to record these items on sales tickets and indicate “hostess gift” or “gift-with-purchase.” There are two important reasons for this:

1. If you should ever be audited, these records will help you prove business rather than non-business use of inventory.
2. As a businessperson, you should know what this form of incentive has cost you during the year.

Non-recovered sales tax - Independent Beauty Consultants may prepay sales taxes that are not reimbursed by the customer, such as product discounts, hostess gifts, gifts-with-purchase and differences in sales tax rates. More information about non-recovered sales tax can be found in the section discussing Schedule C, Part III, Cost of Goods Sold.

Business Use of Your Home
To support any office-in-home deductions, you will need to retain copies of records, documents and receipts for the following:

- Repairs and maintenance of your house
- Insurance premiums
- Mortgage interest
- Rental payments
- Painting and roof repairs
- Real estate taxes
- Utilities
- Other home related expenses

Automobile Expenses
Deducting automobile expenses requires good recordkeeping. The most important documentation is a record of your actual business miles. You need to be able to prove that these miles were driven for business. The Company strongly suggests that you maintain a mileage log to help you satisfy these recordkeeping requirements. Mileage logs may be obtained at any office supply store.

You should make each entry in the log at or near the time when you use your car for business, and each entry should specify:

1. The date and use of the automobile.
2. Number of miles driven.
3. Purpose of the trip (e.g., a selling appointment).

You should also record your odometer reading on the first and last days of the year so you can determine total miles driven during the year. This way, you will have to keep records of business miles only (and the mileage related to the first and last business stop), not all of your driving miles.

If you use more than one car for your business, you must keep separate records for each vehicle. In addition, depending on which expense method you choose, you may need to keep all receipts or other documents (cancelled checks are not sufficient) such as:

- Gas (consider using a credit card)
- Repairs
- Tires, oil, supplies, etc.
- Lease payments
- Car insurance payments
- Registration fees
- Interest on car loan
- Parking fees and tolls
- Personal property tax
- Cost of your automobile for the depreciation deduction described under Form 4562 – Depreciation and Amortization.

More information on automobile expenses and expense methods and information if you drive a Mary Kay career car can be found in the section discussing Schedule C, Part II, Expenses.

Business Travel
It is your responsibility to prove that any given trip is primarily for business. Your datebook or daily planner is an important tool for documenting any business travel expenses. You'll want to use it to record each selling appointment or team-building appointment held at your destination. Tax regulations require you to record the following specific information about deductible travel expenses:

1. The amount you spend each day on transportation, meals, lodging, cleaning and laundry, phone calls, etc., totaled into reasonable categories, such as "tips" and "taxis." Be sure to

obtain and save receipts or other documentation to support these amounts. A cab driver will give you a receipt if you ask for one, as will any restaurant.

2. The time spent on business activities.
3. The dates of departure and return and the number of days spent on business.
4. The destination, designated by the name of the city, town, or similar description.
5. The business purpose of the trip or the business benefit gained or expected to be gained as a result of the travel.
6. If the travel purpose is to attend a Mary Kay event, it is helpful to retain handouts, meeting agendas, etc. to document this travel.

More information regarding deductible business travel expenses can be found in the section discussing Schedule C, Part II, Expenses.

Business Meals and Entertainment

Recordkeeping is especially important for business entertainment expenses because a deduction may be completely disallowed if you have not kept proper records. Your datebook or daily planner should contain the following information:

1. The amount and a description of each separate expenditure.
2. The date, time and place the entertainment was provided.
3. The business purpose, including a description of the business benefit derived.
4. The identity of the participants and their business relationship to you.

If the entertainment was *associated with* your business, you must also record:

1. The date and duration of the business discussion preceding or following the entertainment.
2. The place where the business discussion was held.
3. The nature of the discussion and its purpose as well as the benefit derived or expected from the discussion.
4. The identity of the people entertained who participated in the business discussion.

Maintain receipts to support your expenditures. A cancelled check is generally not sufficient documentation. More information regarding deductible business meals and entertainment can be found in the section discussing Schedule C, Part II, Expenses.

Other Business Expenses

Here is a list of the expenses that may be deductible and the records or documents you will need to retain to substantiate some of these expenses:

Advertising costs

To support a deduction for advertising, you should retain:

- The packing slips/invoices from your orders of Mary Kay® Section 2 sales literature, such as *The Look* brochure and copies of your Preferred Customer Program enrollment forms and online enrollment confirmations.

- Receipts for other expenditures such as printing of business cards, newspaper ads, greeting cards you send to customers, and cost for participating in the Mary Kay® Personal Web Site program.

Bad debts from sales or services – In the unlikely event that you have a problem with a bad debt, such as a returned check or a refused credit card payment, you should document:

- The existence and nature of the debt
- That the debt corresponds to an item you previously or currently reported as income (original sales ticket)
- That there is reason to believe that you will never collect the debt (document phone calls and other attempts to collect).

Commissions and fees - Dovetail commissions you have paid can be deducted. You'll want to support these deductions with entries in your datebook and on a sales ticket.

Product and liability insurance - Keep any cancelled checks, invoices, receipts from money orders or cashier's checks and credit card receipts used to purchase insurance. More information about deductible insurance can be found in the section discussing Schedule C, Part II, Expenses.

Interest on business loans - Keep all bank statements showing the amount of interest you paid as well as documentation that shows the business purpose of the loan or other indebtedness.

Legal and professional services – Keep all receipts and statements related to professional services such as accountants and lawyers.

Office expenses – This includes office supplies such as stationery, paper clips as well as postage stamps, *myCustomers+*™ , etc. As always, keep receipts.

Rent on business property - Keep all rental and lease agreements and cancelled checks or credit card receipts to support a leased Mary Kay office or office-in-the-home deduction.

Repairs and maintenance on office equipment - Keep all receipts for repairs and maintenance related to business equipment such as copiers and computers.

Taxes and licenses – Proper supporting documents will vary, depending on the type of tax. Keep all receipts, packing slips/invoices, copies of tax returns, statements, cancelled checks, licenses, etc.

Supplies - Keep copies of Mary Kay® Section 2 supply orders sent to the Company and the packing slips/invoices returned with your orders, along with receipts for any other supply purchases such as cotton swabs and cotton balls.

Business telephone – Documentation should be kept for all long-distance calls. It may be helpful to keep a log of these calls and include the name of the person who was called, the business nature of the call and the phone number. If you have call waiting or a second phone line, which is used only for business purposes, retain your bills to support the deduction.

Business cellular phone usage - There is recent IRS guidance which addresses the business use of cell phones as it relates to an employer-employee relationship. However, the IRS guidance does not address whether the same factors apply to self-employed individuals. Cell phone expenses should be considered in light of other guidance concerning the ordinary and necessary nature of business expenses and whether they are commensurate with the business income generated. Individuals should seek the counsel of their tax advisor for specific guidance on the deductibility of cell phone expenses.
Wages paid to an assistant or household help – You should contact your personal tax advisor for advice on this matter.

Dues and publications - Keep copies of your bills for these items and your cancelled checks, charge receipts, or other receipts to support this deduction.

Shipping, Handling, Postage and Freight – You should retain receipts of expenses incurred in your business.

Preferred Customer Program – The cost of Preferred Customer Program premiums is deductible. If the premium is a Mary Kay® Section 1 product from your inventory, you will want to treat it as if it were a cost-of-goods-sold deduction and record these items on sales tickets, indicating “gift-with-purchase.” If the premium is a Mary Kay® Section 2 item, the cost of the item is deductible as a business expense but limited to $25 per recipient.

Hostess gifts other than Mary Kay® product – Hostess gifts of Mary Kay® Section 1 product are deducted through the cost-of-goods-sold deduction. At times, however, you may want to present hostess gifts of Mary Kay® Section 2 items. Your cost of these items is deductible as a business expense but it is limited to $25 per recipient.

Personal Casualty Losses – The new Tax Cuts and Jobs Act” (P.L, 115- 97) has expanded the deduction for personal casualty losses to include losses in federally declared disaster area. The deduction was made retroactive back to 2016 and 2017. You should contact your personal tax advisor for advice on this matter.

2017 Record Checklist

Income
❑ Sales tickets (including Customer Delivery Service – CDS) ❑ Form 1099-MISC ❑ Income Advisory Statement ❑ Monthly Commission Statement ❑ Bank deposit slips and statements
Inventory/Product Sales
❑ Consultant order forms ❑ Packing Slips/Invoices from product orders (including CDS) ❑ Non-business use records ❑ Copies of money orders, cashier’s checks, credit card receipts for product purchased ❑ Year-end inventory counts ❑ Record of product given as gifts ❑ Non-recovered sales tax
Business Use of Your Home Expenses
❑ Repairs and maintenance receipts ❑ Insurance premiums ❑ Mortgage interest ❑ Rental payments ❑ Painting and roof repairs receipts ❑ Real estate taxes ❑ Utilities
Automobile Expenses
❑ Business mileage log ❑ Gas receipts ❑ Repair bills ❑ Tires, oil, supplies, etc. ❑ Lease payments ❑ Car insurance payments ❑ Registration fees ❑ Interest on car loan ❑ Parking fees and tolls ❑ Personal property tax ❑ Cost of vehicle for the depreciation deduction
Business Travel Expenses
❑ Lodging ❑ Meals ❑ Transportation ❑ Cleaning and laundry expenses ❑ Business calls ❑ Tips related to above expenses

Business Meals and Entertainment
- Meals   - Entertainment
Other Business Expenses
- Advertising   - Proof of bad debts   - Product and liability insurance   - Interest and loan documents on business loans and credit cards   - Legal and professional services (personal tax advisor)   - Office expenses   - Rent on business property   - Repairs and maintenance on office equipment   - Supplies   - Taxes and licenses   - Business telephone bills   - Wages paid to an assistant/household help   - Dues and publications   - Shipping, Handling, Postage and Freight bills   - Preferred Customer Program premiums   - Hostess gifts

Tax Forms and Schedules Summary

This section of *Tax* Essentials introduces the forms and schedules of the federal tax return that are important to an Independent Beauty Consultant. Each of these forms and schedules are summarized on Form 1040. More information about some of the forms and schedules can be found in subsequent sections. **In addition, the most updated IRS forms**, **instructions and publications can be found online at *www.irs.gov/forms-instructions.***

Form 1040 (U.S. Individual Income Tax Return)
As an Independent Beauty Consultant, you are required to report your income and expenses on Schedule C. You will need to use the long version of Form 1040 (as opposed to the shorter versions, Forms 1040EZ or 1040A). All of the income, deductions, credits, etc., for which you provide details on other forms and schedules are summarized on Form 1040.

Schedule C - Profit or Loss from Business
Because you are a sole proprietor of your Mary Kay business, the IRS requires you to complete a Schedule C. Independent Beauty Consultants may **not** use Schedule C-EZ. The standard Schedule C **must** be used because it accounts for your inventory sales. Schedule C is the most important form for your Mary Kay business and will be described in greater detail later.

Form 4562 Depreciation and Amortization
The IRS will permit you to deduct a portion of the decrease in value of certain property used in your business. If you use property in your business (such as a computer) you must complete Form 4562 and write in the amount on Schedule C, line 13. Depreciation is a complex matter and is discussed in further detail later in this guide. Your personal tax advisor can also assist you with this subject.

Form 8829 Expenses for Business Use of Your Home
Form 8829 is used to calculate the allowable expenses for business use of your home. This form is discussed in further detail in subsequent sections. IRS Publication 587 *Business Use of Your Home* may also be helpful to you. It is available online at *www.irs.gov/forms-instructions* by typing in "Publication 587" in the search field.

Form 1040-ES Estimated Tax for Individuals
Form 1040-ES is used to estimate your tax liability and make payments to the IRS throughout the year. Self-employed individuals who have no tax withheld from their business income and have an estimated tax liability of $1,000 or more are required to estimate and pay taxes in advance to avoid a large lump-sum tax bill or penalty later.

Schedule SE (Computation of Social Security Self-Employment Tax)
Schedule SE is used to determine the amount of Social Security tax you must pay as a self-employed person. You may be required to complete this form and enter the final amount on your Form 1040. Mary Kay Inc. cannot deduct Social Security tax from what you earn.

You may want to review the following IRS publications for more detailed analysis of the filing requirements for use in preparing your tax returns. They are available online at *www.irs.gov/forms-instructions* by typing in the publication name in the search box.
IRS publications that provided more detailed analysis:

Publication 463 *Travel, Entertainment, Gift and Car Expenses*
Publication 587 *Business Use of Your Home*
Publication 946 *How to Depreciate Property*

At this website, you will also find tax forms for this year and instructions on how to fill them out. You can also obtain these publications and forms by calling the IRS at 1-800-829- 3676. Please make sure to ask the IRS for the applicable publications for use in preparing your 2017 tax returns as the rules change from year to year.

Understanding Schedule C

Income earned from your Mary Kay business and your related business expenses is reported on Schedule C. The net (after expenses) profit or loss calculated on Schedule C is then carried to the first page of Form 1040 and combined with your other income (and the income of your spouse if you are married and filing a joint return).

Schedule C is divided into five major parts. Each of these parts will be covered in detail below.

<u>Schedule C, General Information</u>
Line-by-Line Instructions

Item A - Principal Business or Profession, Including Product or Service
The principal business for an Independent Beauty Consultant or Independent Sales Director is "retail sales," and the product is "cosmetics."

Item B - Principal Business Code
Code 454390 is the correct code for your Mary Kay business.

Item C - Business Name
A business name is not required on your Schedule C. However, if you choose to list one, please do not use the Mary Kay Inc. or any other Company-owned trademarks and trade names.

Item D - Employer Identification Number
An Employer Identification Number (EIN) is not usually required unless you have employees. In addition, Mary Kay Inc. will continue to issue your Form 1099-MISC under your Social Security number even if you do have an EIN. This is because your Independent Beauty Consultant or Independent Sales Director Agreement is between you and Mary Kay Inc. Do not enter your Social Security Number on this line.

Item E - Business Address
Generally, most Independent Beauty Consultants conduct business from their homes; the home is used for business record keeping, correspondence, telephone calls to customers, business entertainment, product storage and other business activities. The IRS prefers the use of a street address instead of a box number.

Item F - Accounting Method
There are two basic methods of reporting business income and deducting business expenses—the *cash method* and the *accrual method*. Many Independent Beauty Consultants and Independent Sales Directors use a hybrid of the two methods, otherwise known as a *modified accrual method*. Most small businesses that have inventory also use this method. According to the modified accrual method, income is reported for the year in which it is actually received, and deductions are taken for the year in which the expenses are actually paid. However, there are two important exceptions to the general rule. These two exceptions are: (1) purchases of inventory and (2) depreciation of business assets.

Item G - Material Participation
Material participation in your business is necessary or your business may be classified as a "passive activity." Most Independent Beauty Consultants will check "yes."

Item H - First Schedule C
Check only if you began your Mary Kay business in 2017.

Part I - Income
Part I of Schedule C is used for reporting your business income. When you begin your Mary Kay business, the majority of your income will result from personal sales, but as you progress in your Mary Kay business, income may come from a number of sources:

- Personal sales (skin care classes, facials, on the go appointments, online sales, etc.)
- Reorders and the Preferred Customer Program
- Personal Team and Independent Sales Director commissions and bonuses
- Company awards, incentives and prizes
- Career Car program

You can use the following records and documents to help you complete Part I of Schedule C:

Form 1099-MISC - If you have ordered more than $5,000 in wholesale merchandise during the calendar year, or if you have received $600 or more in commissions, prizes or awards, you will receive Form 1099-MISC in the mail from the Company. This form will be mailed to you no later than January 31 and you should receive it in early February. Form 1099-MISC will show your income from commissions, prizes and awards. The information reported on Form 1099-MISC is also provided to the IRS and state revenue departments. Receiving a Form 1099-MISC with box 9 checked means that you purchased $5,000 or more worth of wholesale merchandise from the Company between December 2016 and November 2017, but the exact amount is not reported to the IRS. Details of income will be reflected on the Income Advisory Statement.

Income Advisory Statement - All Independent Beauty Consultants and Independent Sales Directors may access an electronic copy of their Income Advisory Statement on the Mary Kay InTouch® Web site. A copy of the Income Advisory Statement will also be mailed to you if you receive Form 1099-MISC or earn prizes/awards of $200 or more.

An Income Advisory Statement reflects:

- **Personal team commissions, team-building bonuses, Independent Sales Director and Independent National Sales Director commissions and bonuses**

- **A list of prizes and awards**

- **Car program net payments paid by Mary Kay Inc.**

- **Car program co-payments that you made.**

- **A year-end summary of Mary Kay® Section 1 and 2 purchases** – Please note that this summary includes only purchases made January 1 through November 30, 2017. You should add your December 2017 purchases to the summary total to get an accurate year-to-date amount.

- **Preferred Customer Program payments**

Monthly Commission Statement – *We suggest keeping a file of your Monthly Commission Statements as documentation for your Mary Kay income.*

The Monthly Commission Statement is available online. Keeping a file of these statements can provide the details needed to support your tax return.

Using the modified accrual method of accounting, your income is reported for the year when it is *actually received*. Commission checks are received the month following the activity that generated the commission; e.g. the commission amount shown on your December 2016 monthly Commission Statement was actually paid (and received) in January 2017. Thus, the commission reported is generally equal to the commissions reflected on the statement for December of the prior year, plus the statements through November of the current year. In other words, the amount reported for personal team commissions on your 2017 Form 1099-MISC will agree with the commission statements dated December 2016 through November 2017.

Line-by-Line Instructions

Use the following information to help you complete Part I of Schedule C:

Line 1 - Gross Receipts or Sales
Report the total of all Mary Kay® product sales including Customer Delivery Service (CDS) sales. Also, report all other income you received in your business including the total of the prizes, awards, commissions and automobiles reported to you by Mary Kay on Form 1099-MISC on Schedule C, Part I, line 1. **Do not** include hostess gifts or any product given away (bonus or gift-with-purchase) or sales tax in your personal sales total.

Line 2 - Returns and Allowances
Occasionally you will receive product back for refund or exchange. It is suggested that you use a regular sales ticket as an itemized receipt to document the return of merchandise. Keep a copy of the sales ticket to support the amount you include on your tax return as "returns and allowances." **Do not include any sales tax you refund to the customer on this line.**

Line 4 - Cost of Goods Sold
This deduction is calculated in Part III of Schedule C and carried to line 4 of Part I. The "cost of goods sold" is your cost of merchandise sold to your customers. As was mentioned earlier, this deduction is an **exception** to the general rule that expenses are deductible when paid. You **may not** deduct the cost of unsold inventory that remains on hand at the end of the year. More information on Cost of Goods Sold can be found later in this guide.

Line 6 –Other Income
Include the value of any prizes or awards related to your business that are not included on line 1. This could include prizes and awards you received from your Independent Sales Director or National Sales Director. The IRS instructions request that you attach a schedule of all items reported here.

<u>Schedule C, Part II - Expenses</u>
Part II of Schedule C is used for reporting your business expenses.

An Overview of Expenses
As an independent business person, you are allowed to deduct all *necessary* and *ordinary* business expenses of *reasonable* amounts that are paid in the tax year (with the **exception** of unsold inventory on hand at year-end, as explained under Part I, Line 4, Cost of Goods Sold).

- The IRS considers an expense *necessary* if it is helpful and appropriate to the business.
- An expense is *ordinary* if it is one that is common and accepted in the particular business activity.
- A *reasonable* expense is one that is not lavish or extravagant.

Expenses that are *primarily* for your personal benefit, even though there may be *some* business justification, are not deductible. The IRS has specific guidelines on some of these determinations, and others are made on a case-by-case basis. **The Company recommends you should not advise potential team members or Independent Beauty Consultants on the tax deductibility of items.**

Many people believe that if an expense is tax deductible, it has no effect on your true income. The fact is – and this is an important point to remember – any time you spend money for your business, your real profit is reduced. For example, if you are in a 28 percent tax bracket, and you spend $100 on telephone calls, the tax advantage is only $28. The remaining $72 is gone from your business. Whatever you spend should help you increase sales enough to cover the expense and provide additional profit as well.

Profit or Loss?

In some cases, the IRS may try to claim that your Mary Kay activity is not intended to make a profit. If losses occur in several consecutive years, they may be disallowed. If your Mary Kay business produces a profit in *at least three of any five consecutive years*, it is presumed you are in business to make a profit.

If you are a new Independent Beauty Consultant and you expect to make a profit in later years, but perhaps not in the first year or two, you may delay the IRS evaluation of your profitability until your fifth year as an Independent Beauty Consultant. If, at that time, you find that you have made a profit in three of the five years, the IRS will presume you intended to make a profit. To delay the IRS evaluation, you must complete Form 5213 (Election to Postpone Determination).

If you do not meet the three-out-of-five year test, the IRS will try to determine if you are conducting your business like you intend to make a profit. The IRS considers the following factors when making this determination:

1. Whether you conduct your direct selling activities in a businesslike manner and keep complete and accurate records.
2. Whether the time and effort you spend on your Mary Kay business indicate that you intend to make it profitable.
3. Whether you depend on income from your Mary Kay business for your livelihood.
4. Whether your losses are due to circumstances beyond your control or are normal when starting a direct selling business.
5. Whether you have changed your methods of operation in order to make a profit.
6. Whether your Mary Kay business makes a profit in some years and how much it makes.

Line-by-Line Instructions

Use the following information to help you complete Part II of Schedule C.

Line 8 - Advertising
Purchases of materials available from Mary Kay Inc., such as sales literature, may be deductible as advertising expenses. The following expenses might be considered advertising:

- Company-produced sales literature, such as *The Look* brochure
- Cost of the Preferred Customer Program names submitted
- Greeting cards for customers
- Business cards
- Mary Kay® Personal Web Site program

Line 9 - Car and Truck Expenses
If you use your car for Mary Kay business-related purposes, the IRS allows you to deduct business-related local transportation costs (for example: driving to and from selling appointments). **However, unless your business qualifies for an office-in-the-home tax deduction, the mileage from your residence to the first business stop and from the last business stop back home is considered personal mileage and *not* business mileage. If you have an office in your home that qualifies as a principal place of business, you can deduct your daily transportation costs between your home and another work location in the same trade or business. For further information, see Publication 587 *Business Use of Your Home.***

Mileage for travel away from home (overnight) is also deductible but must be deducted under travel and entertainment on line 24a and is subject to additional tests.

There are two ways to determine the deductible amount of automobile expenses. They are:

- The actual expense method
- The standard mileage rate method

Please consult with your personal tax advisor to determine which method is most beneficial to you.

Actual Expense Method
To use the actual expense method, you must keep documentation of all car expenses, including gas receipts and mileage. If you want to use the actual expense method for a car you lease or a Mary Kay career car, you must use it for the entire lease period.

You should also keep a record of the cost of your automobile for the depreciation deduction described under Form 4562 – Depreciation and Amortization. Accelerated depreciation of your automobile is not available unless your qualified business usage exceeds 50 percent. For business use less than 50 percent, you must use the straight-line depreciation over five years.

Standard Mileage Rate Method
To use the standard mileage rate method, you must keep records of:

- Mileage
- Interest on your car loan
- Automobile personal property taxes
- Parking fees and tolls

You do not need to keep records of gasoline purchases. ***The 2017 standard mileage rate for business miles is 53.5 cents per mile*** down from 54 cents***.***

There are limitations to this method:

1. If you want to use the standard mileage rate method for a car you own, you must choose to use it the *first* year the car is available for use in your business. In later years, you may choose to use either the standard mileage rate method or actual expense method.

2. If you use the standard mileage rate method for a car you lease or a Mary Kay career car, you must use it for the entire lease period.

3. If you own or lease five or more cars that are used for business at the same time, you cannot use the standard mileage rate method for the business use of any car. However, **you may be able to deduct your actual expenses for operating each of the cars** in your business.

If You Have Earned the Use of a Career Car
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. Whichever method you choose, you must use it consistently throughout the time you drive the car because it is a leased vehicle.

Occasionally someone preparing a tax return will not understand how car lease payments or standard mileage expenses can be deductible when you have not personally made a cash payment. It is irrelevant that you personally did not make the actual cash payment. The relevant facts of this situation are:

- You have received compensation,

  and

- Your income is being spent for a business purpose.

The income that you should include on your tax return is reported to you as a prize/award on Form 1099-MISC, box 7 (Nonemployee Compensation). The Income Advisory Statement will detail the net amount paid by Mary Kay Inc. for your automobile that was included in box 7. The Income Advisory Statement will also detail any co-op payments you may have made.

Actual Expense Calculation for Earning the Use of a Career Car
The actual expense deduction is calculated in a six-step process:

> **Step 1** – Add the amounts detailed on your Income Advisory Statement as Mary Kay career car amounts and automobile co-op payments.
>
> **Step 2** – You may receive a letter from the Mary Kay Tax Department in January following the year you earned the use of the car. This letter is sent to drivers of new career cars having a fair market value over IRS regulated amounts. An inclusion amount must be added to your income if the fair market value exceeds a specified IRS amount. The letter will have a

table reflecting the total possible inclusion amount, as prescribed by the IRS. The initial letter is used for the entire period in which you have earned the use of the car. This inclusion amount for any tax year is then subtracted from the expenses you totaled in Step 1. Thus, you now have an adjusted total automobile lease expense. This step effectively reduces your automobile lease deduction by the inclusion amount.

Step 3 – Identify your actual automobile expenses. These expenses may include gasoline, oil, repairs, insurance (noted on your Income Advisory Statement), tires, etc.

Step 4 – Evaluate your business usage of the car by dividing total business miles driven for the tax year by total miles driven for the year. The resulting percentage is your business use percentage.

Step 5 – Take the total adjusted automobile lease expense (compiled in Steps 1 and 2) and multiply it by the business use percentage (calculated in Step 4). The product is your total automobile lease deduction, which is reported on your Form 1040, Schedule C, line 20a.

Step 6 – Take the total of your other automobile expenses (compiled in Step 3) and multiply it by the business use percentage (calculated in Step 4). The product is your car and truck expense deduction, which is reported on your Form 1040, Schedule C, line 9.

Other Car Deductions
With either method, the **business portion** of the interest on an auto loan, parking fees and tolls, and any property tax assessed on your auto are deductible.

The remainder of property tax attributable to personal use of the car may be deducted on **Schedule A (Form 1040)** if you are eligible to itemize deductions apart from your Mary Kay business.

Additional information is available in IRS Publication 463 *Travel, Entertainment, Gift and Car Expenses.* Due to the complexity of the law in this area, it is suggested you consult your personal tax advisor.

Line 10 - Commissions and Fees
Cash bonuses paid by a Sales Director to unit members as a result of unit contests can be deducted on this line. Any dovetail commissions you have paid can also be deducted on this line. You'll want to support these deductions with entries in your datebook and on a sales ticket.

Line 11 – Contract Labor
Amounts paid for contract labor are deductible on this line. Payments for contract labor are often subject to reporting requirements. Often contract labor payments are confused with wages. Please consult your personal tax advisor if you have expenses of this nature.

Line 12 - Depletion
This line is not applicable to your Mary Kay business.

Line 13 - Depreciation and Section 179 Expense Deduction
Depreciation may be applicable to your Mary Kay business in three areas:

1. Automobiles used for business.
2. Office furniture and office equipment (including computer equipment).
3. The portion of your home that is used for business.

The amount you enter on line 13 is carried over from Form 4562 - Depreciation and Amortization. Form 4592 is discussed in further detail later in this guide.

Line 14 - Employee Benefit Programs
This line is generally not applicable to your Mary Kay business.

Line 15 - Insurance (Other than Health)
The cost of a few types of insurance is deducted on this line. The most common types are:

- The Mary Kay product insurance plan or similar insurance on your inventory that you may obtain.
- A general liability plan or similar insurance to protect you from liability claims arising out of your activities as an Independent Beauty Consultant.

Do not include the following on this line:

- Personal insurance including life, disability and long-term care.
- The business portion of your homeowner's insurance. If you qualify for the office-in-the-home deduction, this type of insurance is deducted on Form 8829.
- The business portion of qualified auto insurance is deducted on line 9, not here, if you use the actual expense method of figuring your auto expense deduction. This would include the business portion of insurance paid by the Company and included on Form 1099-MISC and any co-op auto insurance payments you make.
- Self-employed persons may be able to deduct a portion of their health insurance premiums in 2017 for themselves, spouses and dependents. Please see the instructions to Form 1040 to compute the deductible amount. The calculated deduction amount is reported on Page 1, line 29 of Form 1040.

Line 16a - Mortgage Interest Paid to Financial Institutions
Because the business portion of mortgage interest paid on your home should be included on Form 8829, this line is not applicable to your Mary Kay business.

Line 16b - Other Interest
Interest you have paid on loans for purchasing business property is deductible. An example is a loan to make the initial purchase of Mary Kay® product inventory. Credit card finance charges are deductible here *only if* you use the credit card for business purchases.

Deduct the business portion of interest paid on an auto loan on line 9.

If borrowed funds are co-mingled (part used for business purposes and part used for personal reasons), generally you allocate the interest expense by tracing disbursement of the borrowed funds to specific expenditures.

Repayment of debt ordinarily has no tax consequences. However, if you allocate a debt to more than one expenditure and repay only part of the debt (i.e. credit card purchases for personal and business use), the allocation can affect your interest deduction.
Generally, repayment of a portion of a debt, which is allocated to more than one expenditure, is treated as repaid in the following order:

1. Amounts allocated to personal expenditures.
2. Amounts allocated to trade or business expenditures.

Allocating repayments first to personal expenditures is intended to minimize the loss of deduction for interest expense.

A special rule applies when you repay a debt from the proceeds of another debt. To the extent the proceeds of the other debt are used for the repayment, the replacement debt is allocated to the expenditures to which the repaid debt was allocated. The normal allocation rules apply, however, to the extent proceeds of the debt are used for purposes other than the repayment.

You will want to maintain separate accounts (credit cards or bank loans) for each type of use—personal and business.

Line 17 - Legal and Professional Services
Deduct any payments to accountants, lawyers or other professionals for services related to your Mary Kay business on this line. For example, the fee paid to an accountant in 2017 for preparing the portion of your 2016 income tax return that related to your Mary Kay business.

Line 18 - Office Expense
This includes office supplies such as stationery and paper clips as well as postage stamps purchased for use in your business.

Line 19 - Pension and Profit Sharing Plans
This line does not apply to your Mary Kay business.

Line 20a – Rent or Lease on Vehicles, Machinery and Equipment
The business portion of automobile lease expenses should be reported on this line. Additionally, you may occasionally incur rental or lease expenses on property used in your business, such as a copier, fax machine or computer.

Line 20b – Rent or Lease on Other Business Property
If you lease an office for your Mary Kay business, which is separate from your home, the rent on this office is deducted on this line. If you live in a rented or leased apartment or home, and you qualify for the office-in-home deduction, the business portion of your rent or lease payment may be deductible on Form 8829.

Line 21 - Repairs and Maintenance
Deduct the cost of repairing business equipment, such as a copier, on this line. Deduct the business portion of automobile repairs on line 9, if you use the actual expense method.

Line 22 - Supplies
Sales aids are the major expense in this category. These include most Mary Kay® Section 2 purchases and purchases of other items used during selling appointments, such as cotton swabs or cotton balls. Supplies also include the cost of the Starter Kit for new Independent Beauty Consultants.

Line 23 - Taxes and Licenses

Sales tax: Sales tax on business purchases (excluding purchases of Mary Kay® Section 1 products) should be included with the cost of the item and deducted on the appropriate line. For example, tax on cotton swabs would be included on line 22. Sales tax paid to the Company for purchases of Mary Kay® Section 1 products is not deductible because you recover this tax when you sell to your customers. However, please see information on non-recovered sales tax in the section discussing Schedule C, Part III, Cost of Goods Sold.

Real estate tax: The business portion of real estate taxes is deductible *only if* you qualify for the office-in-home deduction.

Property tax on autos: The business portion of property taxes paid on your auto is deductible on line 9. In some places, property tax is paid at the same time you renew your license plates.

State income tax: State and local income taxes are not deductible as business expenses. However, they may be deducted as itemized deductions on Schedule A of Form 1040 as well as the non-business portion of taxes paid for real estate and personal property.

Self-employment tax: Although you are entitled to deduct one-half of your self-employment tax, this amount is not deducted on your Schedule C. It should be deducted on line 27 of your Form 1040. See the section discussing Schedule SE (Form 1040) for more information on the self-employment tax.

Business and occupation taxes, gross receipt taxes and local business licenses: Any payments for licenses required by your city, county or state to operate your Mary Kay business are deductible on this line.

Line 24a - Travel
As you know, you are authorized to operate your business and sell Mary Kay® products in the United States, Puerto Rico, the U.S. Virgin Islands and Guam. Thus, you can retain your personal team members, even if you move to a different state, and develop team members and a customer base regardless of whether this is different from your own place of residence. Under these circumstances, travel may sometimes be necessary.

The IRS defines business travel as trips that are reasonable and necessary in the conduct of your business, that are directly attributable to your business and that generally require a stay overnight. Local trips are not included.

Travel is classified as either primarily for business or primarily for pleasure. If a trip is primarily for business, you can deduct your travel expenses. If a trip is mostly for pleasure, none of the transportation costs to and from the destination are deductible. However, costs incurred at the destination specifically for business purposes may be deductible.

The burden of proof regarding any particular trip is on you. The regulations stress that the amount of time spent on business activities, as compared with personal activities, is an important factor.

Mary Kay incentive trips are primarily personal recreation. The IRS requires extensive business activities be conducted in order to qualify these expenses as a deductible trip. Therefore, depending on the nature of your activities on the trip, it is likely that the trip will not qualify as a deductible business expense. Please review and discuss with your accountant.

Travel expenses may include:

- **Lodging** - This includes both in route and at the destination, if your business trip is overnight, or long enough that you need to stop for sleep or rest to properly perform your duties.

- **Meals** - This includes money spent for food, beverages, taxes and related tips. However, you may generally deduct only 50 percent of business meal expenses.

- **Transportation** – This includes air, rail or bus fare, or the cost of driving your car. If travel is primarily for business, you can include the miles driven in your car as business miles when figuring your auto expense deduction as explained for line 9.

  The travel portion of the auto expense deduction is then included on this line. For example, if you figure your auto deduction at $4,000 and your total business mileage is 20,000, of which 2,000 miles were driven on a business trip, 10 percent ($400) of the auto deduction would be included on this line.

- **Cleaning and laundry expenses**

- **Business calls –** This includes business communication by fax or other business devices

- **Commuting costs while at the destination -** This would include fares for transportation between the airport and your hotel and between the hotel and your business meeting place.

- **Baggage and sample display material shipping costs**

- **Tips related to above expenses**

- **Convention expenses -** You can deduct convention expenses if there is a sufficient relationship between your business and you attending the convention. Assuming this test is met, expenses for conventions in the United States - Seminar, Leadership Conference, Career Conference, etc. – may be treated the same as other business travel expenses.

The travel expenses of your spouse are tax deductible *only* if your spouse is your employee, the spouse is traveling for a valid business purpose and the expenses incurred would otherwise be deductible. In general, for your spouse to be considered your employee, he/she must be paid a salary and you must pay all appropriate taxes (i.e. applicable federal and state withholding, Social Security and Medicare, unemployment insurance, etc.) and file appropriate payroll tax returns. Before taking a tax deduction for spousal travel, you should consult your personal tax advisor.

Another method that can be used for incidental expenses is the optional method. Instead of keeping records of your actual incidental expenses, the IRS allows you to use the optional method for deducting incidental expenses only if you did not pay or incur meal expenses on a day you were traveling away from your tax home. The amount of the deduction is $5 a day.

Line 24b - Meals and Entertainment Deductions
You may deduct 50 percent of the cost of your meals while traveling as explained above.

You can deduct ordinary and necessary expenses for entertaining others if these expenses are either directly related to or associated with the active conduct of your business. You also must be present at the meal. The deductibility of these business meals (including taxes and tips) and entertainment is limited to 50 percent of the allowable expense.

The regulations do not specify exactly what constitutes “entertainment” – only that those activities are generally considered to be entertainment, amusement or recreation are included. To qualify as directly related entertainment, the expense must meet certain requirements:

- Active business discussion: During the entertainment period, you must engage in a business meeting, discussion or other business transaction for the purpose of obtaining income or some other business benefit. An example might be taking a prospective team member to a fashion show in which Mary Kay® products are used. You do not have to show that income or other business benefit was actually achieved as a result of the entertainment expense. The business entertainment must be part of the active conduct of your business and cannot be merely incidental to it.

- **Clear business setting: Entertainment expenses incurred in a clear business setting, directly in support of your business, are considered to be directly related. To satisfy this test, you must establish that any recipient of the entertainment would have reasonably known that you had no motive other than furthering your business.**

Those entertainment expenses “associated with” the active conduct of a trade or business must meet essentially the same tests as “directly related” expenses. However, you do not have to discuss business during the entertainment. Instead, the entertainment must be directly preceded or followed by business discussion.

Other Entertainment Considerations
Please note that merely going to lunch with a team member, for example, where each person pays their own bill, is not considered entertainment—the cost of your lunch is not deductible.

Home entertainment may be deductible if it is directly related or associated with the active conduct of business. A holiday open house is a good example of an expense, which may be deducted as home entertainment.

The IRS will disallow any deduction for entertainment if the entertainment is considered lavish or extravagant. Although the law does not define “lavish” and “extravagant,” a $200 lunch for two people may be considered lavish and extravagant.

Line 25- Utilities
Certain telephone expenses are deductible on this line. The base rate of your personal telephone is not deductible. Long-distance calls of a business nature and the business use percentage of additional features (such as call waiting) are deductible. In addition, if you have a second phone, which is used only for business purposes, the entire phone expense is deductible.

Line 26 - Wages
Amounts paid for office assistance are deductible here. Any amounts that Independent Beauty Consultants “pay” themselves are not deductible for tax purposes and should not be reported here. However, please note that payments to office assistants etc are considered wages subject to withholding and reporting requirements. There are additional complexities for wages paid to a spouse or children or domestic help and therefore, you should contact your personal tax advisor for advice on these matters.

After you resolve withholding or reporting requirements, the primary issue involved in wages paid to a spouse or children is the reasonableness of the amounts paid. To support your deductions, you should assign specific duties to your spouse or child to be performed on a regular basis and keep a record of actual hours worked. Set a reasonable hourly wage based on the rate which you might pay to an unrelated employee for duties similar to those being performed by your spouse or child.

If you qualify for an office-in-home deduction, the business portion of cleaning service payments may be deductible. Figure the deductible amount in the same way as other office-in-home expenses. These expenses are deducted on Form 8829.

Line 27a - Other Expenses
Other expenses are detailed in Part V of Schedule C and carried to line 27a.

Line 30 - Expense for Business Use of your Home
To claim a deduction for business use of your home, you can use either simplified method or Form 8829, but not both.

Simplified Method

You will figure your deduction by multiplying the area (measured in square feet) used regularly and exclusively for business by $5. The area you use to figure your deduction cannot exceed 300 square feet. The deduction is subject to gross income limitation. You cannot use the simplified method to figure a deduction if you rent out your home to another.

Steps to calculate the deduction:

(1) Multiply the allowable area (maximum 300 square feet) by $5.
(2) Subtract the expenses from the business that are not related to the use of the home (e.g., cost of phone, supplies, professional fees, advertising, depreciation on equipment) from the gross income related to the business use of the home. If these expenses are greater than the gross income from the business use of the home, then you cannot take a deduction for this business use of the home.
(3) Take the smaller of the amounts from (1) and (2). This is the amount that the taxpayer can deduct for this qualified business use of his home using the simplified method.

Form 8829

If you are not electing to use the simplified method, then use the form 8829 and transfer the number from line 35 Form 8829 and enter here. If you are not using the simplified method, do not enter square feet on line 30.

Line 32 - At Risk
Normally, you would be personally liable for all losses incurred in your business and would therefore check "32a." However, if you have losses on line 31 for which you are not personally liable, then check "32b."

Schedule C, Part III- Cost of Goods Sold
Part III of Schedule C deals with deductions for the cost to you of the merchandise or product that you sell as an Independent Beauty Consultant and with the inventory of merchandise that you keep in stock.

The cost-of-goods-sold deduction is first calculated in Part III of Schedule C and then carried to line 4 of Part I.

You should remember these four facts about inventory/cost-of-goods-sold deductions:

- The amount of this deduction is not the total of all inventory (product) you purchased during the year, unless you sold exactly what you bought.

- The amount of the deduction is not the amount of product you have in stock at the end of the year.

- The amount of the deduction is the cost of product that you sold or distributed as hostess or incentive gifts-with-purchases during the year. **Thus, stocking up before December 31 will <u>not</u> increase your deduction.**

- **Shipping and handling charges are part of inventory and can be deducted when items are sold to your customers.**

Please note that the IRS issued a revenue procedure concerning small businesses that maintain inventories. This procedure does not affect your Mary Kay business**. Inventory is not deductible until sold.**

Schedule C Line-by-Line Instructions

Line 33 – Methods used to value closing inventory
There are several methods used to value inventory. Many Independent Beauty Consultants and Independent Sales Directors use the cost method.

Line 34 –Change in determining quantities, costs, or valuations
Generally, in your Mary Kay business there will not be a change in determining quantities, costs or valuations between opening and closing inventory. Most Independent Beauty Consultants should mark "no."

Line 36 – Purchases (less the cost of items withdrawn for non-business use)
On this line, record the total amount of Mary Kay® Section 1 purchases made during the year, minus the cost of items you removed from stock for non-business use. Also, include the shipping and handling paid on orders. Do not include the sales tax you paid with your order of Mary Kay® Section 1 merchandise.

The wholesale value of your Mary Kay® Section 1 product purchases should be accumulated on an annual basis. You should add the total from each packing slip/invoice product statement you receive during the year to get an accurate account of items purchased.

Goods removed for non-business use: Inventory you withdraw for non-business use is **not deductible.** Subtract the total cost of goods removed for non-business use from the amount of your total purchases before entering that amount on line 36 of Part III.

Lines 35 and 41 – Beginning and Ending Inventory
Inventory is your stock of merchandise—the product you have on hand.

- **Beginning Inventory:** In your first year as an Independent Beauty Consultant, you will have no beginning inventory. In each year thereafter, your beginning inventory will be the same as the ending inventory count from the year before. In other words, your December 31 ending inventory will be the same as your January 1 beginning inventory. You will enter your beginning inventory—the total cost to you of the product you had on hand on January 1 of the applicable tax year—on line 35 of Part III.

- **Ending Inventory:** An absolute must for any business involving the sale of merchandise is an annual count of the merchandise on hand. You should count your inventory on or as near as possible to December 31. To determine your ending inventory, simply count the quantity of each item you have at year-end and record the amount on a Consultant order form. If you don't do this on December 31, you may need to make adjustments for purchases or sales you make during the intervening period. You will enter your ending inventory—the total cost to you of the product you had on hand on December 31 of the applicable tax year—on line 41 of Part III.

- **Determining the Value of Your Inventory:** After recording the quantity of each Mary Kay® Section 1 product you have, simply extend the amounts as you do when placing an order. Carry the total of Mary Kay® Section 1 products to the summary section and calculate the wholesale cost based on the discount you used when you originally purchased this inventory. It is assumed that the inventory you hold at year-end is from your most recent purchases. (Keep this in mind for years when there are price changes). The figure you end up with is the value of your inventory at your cost. Do not include sales tax in these computations.

- **Unusable Inventory**: Sometimes inventory becomes damaged, out-of-date or otherwise unusable. To take a deduction for these items, you must physically dispose of the inventory and be able to provide proof of its disposal to the IRS. Please contact your personal tax advisor for further advice on this deduction.

  The inventory that you disposed of will not be included in your ending inventory totals. The fact that these items are not part of your ending inventory creates a deduction by increasing your cost of goods sold.

- **About Your Hostess Gifts:** One very important element of the cost-of-goods-sold calculation is Mary Kay® Section 1 product used as hostess gifts. For purposes of completing your income tax return, hostess gifts of Mary Kay® Section 1 products are not deducted separately because the wholesale costs are deducted through the cost-of-goods-sold deduction. There is no deduction for lost profit (the difference between wholesale and retail).

  Another important point to remember is that Mary Kay® Section 1 product used for hostess gifts is not a business gift (limited to $25 per person), but rather an inventory/cost-of-goods-sold deduction. The gift of other items to a hostess is discussed under Schedule C, Part V – Other Expenses.

  As with the unusable inventory discussed earlier, the fact that your hostess product gift items are not included in your ending inventory causes your cost-of-goods-sold deduction to increase. Mary Kay® Section 1 gifts-with-purchase flow through the cost-of-goods-sold deduction also.

Comparative Example
(all numbers are wholesale)

Cost-of-Goods Sold Formula	Including Hostess Product Gifts in Ending Inventory	Excluding Hostess Product Gifts from Ending Inventory
Beginning inventory (line 35)	$ 500	$500
Add Mary Kay® Section 1 purchases*	$7,500	$7,500
Minus non-business use	($300)	($300)
Minus ending inventory (line 41)	($1,550)	($800)
Equals cost-of-goods-sold deduction (line 42)	$6,150	$6,900
** Non-recovered sales tax is included with purchases*		

Lines 37- 39 – Part III is completed as shown above. Lines 37 – 39 are probably not applicable to your Mary Kay business. Remember to carry the amount from line 42 of Part III to line 4 of Part I.

Non-Recovered Sales Tax
Independent Beauty Consultants may prepay sales taxes that are not reimbursed by the customer, such as product discounts, hostess gifts, gifts with purchase and differences in sales tax rates. You may deduct your non-recovered sales tax by simply adding the amount to your current-year purchases on Schedule C, Part III, line 36 of your tax return. Your sales tax deduction will then flow through your cost-of-goods sold deduction. Alternately, you may add non-recovered sales tax to other taxes and licenses on Part II of Schedule C, line 23.

Another option is to apply for a refund from Mary Kay Inc. on non-recovered sales tax related to product discounts and the difference of sales tax collected from a customer living in a lower taxing jurisdiction.

<u>Schedule C, Part IV – Information on Your Vehicle</u>
Answer the appropriate questions concerning your car deduction here if you have claimed vehicle deductions on Part II, line 9 and do not need to file a Form 4562 for any other reason.

<u>Schedule C, Part V – Other Expenses</u>
Expenses in this section pertain to expenses not already noted in Part II.

Clothing - Although it is not required, we recommend that Independent Beauty Consultants dress professionally while conducting skin care classes or other business activities. If you would not otherwise purchase such professional attire, it may seem logical that the cost should be deductible as a business expense. The IRS, however, has taken the position that clothing is essentially a personal expense and, therefore, is not deductible. The courts have consistently applied the following three-part test, which narrowly defines the type of clothing that may qualify as a deductible business expense:

1. The clothing must be of a type specifically required by the business, *and*
2. It must not be adaptable to general or continued usage to the extent that it takes the place of ordinary clothing, *and*
3. It must not be worn in lieu of ordinary clothing.

The IRS has generally taken a strong position that Independent Sales Director suits are *not* deductible because they can be worn as personal clothing. In contrast, the cost of purchasing the Mary Kay® Beauty Coat is deductible because it is worn over existing attire.

Hair care, manicures, etc. - Although your appearance is important to your business, expenses for hair care, manicures, etc., are considered personal expenses and are not deductible business expenses.

Baby-sitting/child care –These expenses are essentially personal expenses and therefore not deductible. However, child care costs incurred in order to allow you to earn income may qualify for the child care credit. Please see a personal tax advisor to review your personal situation.

Bank service charges – This deduction includes any service charges on your business bank account; ProPay account; business MasterCard, Visa or Discover account; money order or cashier's check fees; MasterCard/Visa/Discover card bank processing fees and any similar charges

Dues and publications - Subscriptions to magazines directly related to your Mary Kay business are deductible on this line.

Laundry and cleaning –These expenses are deductible only when you are on a qualified overnight business trip. Report this deduction on Part II, line 24a - Travel. Routine cleaning expenses for your professional attire are not deductible.

Freight - Shipping and handling charges for sending orders to out-of-town customers are deductible as an ordinary business expense. Shipping and handling charges paid to the Company are deducted through the cost-of-goods-sold deduction and should not be included here. Preferred Customer Program shipping and handling may be deducted on this line.

Preferred Customer Program premiums - The cost of most Preferred Customer Program premiums is deductible under "Other Expenses," unless the item is a Mary Kay® Section 1 product from your inventory. In this case, the deduction is taken through the cost-of-goods sold deduction in Part III. The cost of Preferred Customer Program names submitted are deducted on Part II, line 8, Advertising.

Hostess gifts other than Mary Kay® products: Hostess gifts of Mary Kay® Section 1 product are deducted through the cost-of-goods-sold deduction. At times, however, you may want to present hostess gifts of Mary Kay® Section 2 items. Your cost of these items is deductible here as a business expense, but is limited to $25 per recipient.

Bad debts from sales or services: In the unlikely event that you have a problem with a bad debt, such as a customer's check being returned by the bank or a refused credit card payment, and you are completely unable to collect payment from the customer, you may deduct the amount owed to you on this line provided you have the appropriate documentation.

Remember to carry the amount from Part V, line 48, to Part II, line 27a.

Form 4562 – Depreciation and Amortization

Form 4562 (Depreciation and Amortization) is the form you use to supply the IRS with details for this deduction and to calculate the number you need to enter on line 13 of Schedule C, Part II.

You may or may not need to fill out this form. If you plan to depreciate your auto, your computer equipment, your office furniture and other equipment, or the portion of your home used as an office, then you will be making an entry on line 13 of Schedule C and therefore must fill out a Form 4562. If you're not going to claim a depreciation deduction, then this form doesn't apply to you.

The following information will help you fill out your Form 4562 for depreciating these items.

Part I - Election to Expense Certain Tangible Property (Section 179)
You can expense (deduct) up to $510,000 of the business portion of the cost of the property of certain depreciable assets that you began using in your business during the 2017 tax year. Qualifying assets include personal property such as office furniture, some computers, etc.

- This $510,000 limitation applies to all eligible property acquired during the year, not individual assets (property items).
- A computer that is used exclusively at your regular business establishment, such as your office in the home, may qualify for a Section 179 deduction.
- The amount you expense cannot exceed your total taxable compensation.
- Choosing to expense all or part of the cost of an asset results in a reduction of basis for purposes of calculating the depreciation expense.
  Any property that you place in service that you do not use more than 50 percent for business does not qualify for the Section 179 deduction.

Line-by-Line Instructions

Line 1 – The maximum dollar limitation is $ $510,000. This limitation applies to the total cost of all eligible property acquired during the year, not each individual item.

Line 2 – Enter the cost of all Section 179 property placed in service during this tax year.

Line 3 - Threshold amount for 2017 is $2,030,000.

Line 5 – If line 5 is zero, you cannot elect to expense any property. Skip lines 6 through 11, enter zero on line 12 and enter the carryover of any disallowed deduction from 2016 on line 13.

Line 6 – In Column A enter a brief description of the property for which you are making the election. Please note: Do not include any listed property from Part V, such as your automobile. In Column B enter the cost of the property. In Column C enter the amount you elect to expense. You do not have to expense the entire cost of the property. You can depreciate the amount you do not expense.

Line 10 – The carryover of disallowed deduction from 2016 is the amount of Section 179 property, if any, you elected to expense in previous years, but were not allowed to deduct due to the limitation. If you filed a Form 4562 in 2016, enter the amount from line 13 of that form here.

Line 11 – Enter the total taxable compensation income from all sources. This includes Schedule C taxable income (without Section 179 expense deduction), wages, salary, tips and all compensation wages for your spouse, if you are filing jointly. Please consult your personal tax advisor for further clarification as to your specific business limitation.

Part II – Special Depreciation Allowance and Other Depreciation

For certain depreciable assets—personal property such as office furniture, some computers, etc.—that you began using in your business during the 2017 tax year, you are allowed an additional first-year depreciation allowance (deduction) of 50% or 100% of the asset's cost depending on when the property was purchased. The Special Depreciation is not available for non-residential real property (depreciation of office in home).

Assets placed in service	First-year depreciation allowance
1/1/2017 - 9/27/2017	50%
9/28/2017 – 12/31/2017	100%

- To qualify for the 50% first year special allowance, your property must be new, not used. To qualify for the 100% special allowance the property can be either new or used.
- If you have elected to expense a portion of your asset under Section 179, you must first reduce the asset's cost by the Section 179 amount before calculating your 50% special depreciation allowance.
- If you do not wish to claim the special depreciation allowance, you should attach an election statement to your tax return indicating this preference. Please consult your personal tax advisor for further information.
- Any property that you place in service that you do not use more than 50 percent for business does not qualify for the special depreciation allowance. See example for an illustration for the special depreciation and other depreciation.

Example of 50% Special Depreciation Allowance
On July 1, 2017, Mary purchased and placed in service a desk for $700 to be used 100% for qualified business purposes. Mary does not elect to treat her new desk as Section 179 property. The special depreciation allowance is calculated as follows:

Purchase price of desk	$ 700
Business percentage	x 100%
Business portion of desk	700
Less Section 179 amount	(0)
	$ 700
Allowance percentage	x 50%
Special depreciation allowance	$ 350

Example of 100 % Special Depreciation Allowance
On October 1, 2017, Mary purchased and placed in service new desk for $800 to be used 100% for qualified business purposes. Mary does not elect to treat her new desk as Section 179 property. The special depreciation allowance is calculated as follows:

Purchase price of desk	$ 800
Business percentage	x 100%
Business portion of desk	800
Less Section 179 amount	(0)
	$ 800
Allowance percentage	x 100%
Special depreciation allowance	$ 800

Line 14 – Enter the special depreciation allowance for all applicable assets acquired during the calendar year 2017.

Line 15 - This item is not normally applicable to your Mary Kay business.

Line 16 - This line includes depreciation for all assets purchased before 1987. Consult your personal tax advisor or Publication 946 *How to Depreciate Property* for further information on calculating this amount.

Part III – MACRS Depreciation
MACRS stands for Modified Accelerated Cost Recovery System.

Line 17 – Enter your depreciation deduction for assets placed in service after January 1, 1987, and before January 1, 2017 (see Depreciation Percentage tables that follow). Consult your personal tax advisor or Publication 946 *How to Depreciate Property* for further information.

Line 18 – This item is not normally applicable to your Mary Kay business.

Lines 19a through 19c
Line 19 is only for assets placed in service in 2017. The information required for these assets is as follows: (The rules are not the same as for automobiles.)

Column (a) - Class of property: Office furniture and other equipment are classified as 7-year property under MACRS with the exception of computer equipment, which is classified as 5-year property.

Column (b) - Date placed in service: This column is not applicable for these assets.

Column (c) - Basis for depreciation (business use only): The basis is your cost multiplied by your business use percentage minus any Section 179 expense claimed less special bonus depreciation.

Column (d) - Recovery period: The recovery period for office furniture and equipment is seven years. (The recovery period for computer equipment is five years.)

Column (e) - Convention: Either the HY (half-year) or the MQ (mid-quarter) convention will apply to property other than real property such as a residence or building. Under the HY convention, property is deemed to be placed in service in the middle of the year. Under the MQ convention, property is deemed to be placed in service in the middle of the quarter. Consult your tax advisor or Publication 946 *How to Depreciate Property* for further information.

Column (f) - Method of figuring depreciation: Indicate either Modified Accelerated Cost Recovery System (MACRS), or Straight-Line (SL).

Line22-Total Column (g) – Depreciation Deduction: This is the product of the basis for depreciation (Column [c]) multiplied by the first-year MACRS percentage (see table below). The total of line 12, lines 14-17 and lines 19-21 will be the number you enter as your depreciation deduction on line 13 of Schedule C.

Percentages for MACRS 5-year property/Half-Year Convention

Year of Business Use	Percentage
1	20.00%
2	32.00%
3	19.20%
4	11.52%
5	11.52%
6	5.76%

Percentages for MACRS 7-year property/Half-Year Convention

Years of Business Use	Percentage
1	14.29%
2	24.49%
3	17.49%
4	12.49%
5	8.93%
6	8.92%
7	8.93%
8	4.46%

Examples of MACRS deduction

Example 1: Previously, we calculated the special depreciation allowance on Mary's desk. Mary may also depreciate her desk under the MACRS system using a 7-year life as follows:

Business portion of desk	$ 700	
Less 50% special depreciation allowance	(350)	
Basis for depreciation	$ 350	
First-year depreciation percentage	x14.29%	(per MACRS 7-yr property table)
Depreciation	$ 50	

Mary could take the special depreciation allowance ($350) and depreciation ($50) and receive a $400 deduction for depreciation.

Example 2: On August 1, 2017, Mary purchases and places in service a computer for $1,000 to be used 100% for qualified business purposes. This property could be depreciated under the MACRS system with a 5-year life as follows:

Purchase price of computer	$1,000	
Business percentage	x 100%	
Business portion of computer	$1,000	
Business portion of computer	$1,000	
Less Section 179 amount	(0)	
Less 50% special depreciation allowance	(500)	
Basis for depreciation	500	
First-year depreciation percentage	x 20%	(per MACRS 7-yr property table)
Depreciation	$100	

Mary could take the special depreciation allowance ($500) and depreciation ($100) and receive a $600 deduction. Instead, Mary elects to treat her new computer as Section 179 property and deducts the entire $1,000 cost in the current year.

Line 19i – Nonresidential real property
If you qualify for the office-in-home deduction, depreciation is part of the deduction. Even though this amount is listed in Part III of Form 8829, you must also include this amount on Form 4562. For homes purchased or first used for business in 2017, you figure the depreciation as follows:

Column (a) – Classification of property: A home that qualifies for an office-in-home deduction is classified as nonresidential real property.

Column (b) - Date placed in service: The date you begin using part of your home for business use in accordance with all the office-in-home requirements. See Form 8829.

Column (c) - Basis for depreciation: The depreciable basis of your office-in-home is figured by multiplying the percentage of your home used for business by the smaller of the following:

> The cost of your home, plus the cost of any permanent improvements (adjusted basis), excluding the cost of land, on the date you began using your home for business,
>
> **or**
>
> The fair market value of your home (excluding land) on the date you began using your home for business.
>
> The most common method used to calculate the business percentage of use is dividing the square footage of the business portion by the total square footage of the house.

Column (d) - Recovery Period: The recovery period for a home under MACRS is 39 years. Homes acquired and used for business before May 13, 1993 are recovered over 31.5 years.

Column (e) - Convention: MM (mid-month convention) applies to real property and is deemed to have been placed in service in the middle of the month.

Column (f) - Method of figuring depreciation: The S/L (straight-line method) applies.

Column (g) – Depreciation Deduction: Basis for depreciation (Column (c) multiplied by the percentage from the appropriate table (see General Depreciation Tables that follow this section for the correct percentage to use).

Line 20
This type of depreciation is not normally applicable to your Mary Kay business.

Business Use Deduction for Office-in-Home
Use the tables below to determine the appropriate rate for your depreciation deduction. For example, if you bought your home in 2015 and first began using part of it for business in July 2016,

your deduction for 2017 (the second year of recovery) would be 2.564 percent. The rate for 2017 would be 2.564 percent and so forth (Table 2).

Accelerated Depreciation – Post 1986 Assets

Here is how to select the appropriate table to use:

Table 1 if after December 31, 1986, but before May 13, 1993.

Table 2 if after May 12, 1993.

Table 1

General Depreciation System - Straight-Line Depreciation Method
31.5 Years Recovery Period, Mid-Month Convention

Real Estate Placed in Service After December 31, 1986 and before May 13, 1993

The depreciation rate is:
(use the column for the month in the first year the property is placed in service)

Recovery Year	Jan	Feb	Mar	Apr	May	June	Jul	Aug	Sept	Oct	Nov	Dec
1	3.042	2.778	2.513	2.249	1.984	1.720	1.455	1.190	0.926	0.661	0.397	0.132
2 - 7	3.175	3.175	3.175	3.175	3.175	3.175	3.175	3.175	3.175	3.175	3.175	3.175
8	3.175	3.174	3.175	3.174	3.175	3.174	3.175	3.175	3.175	3.175	3.175	3.175
9	3.174	3.175	3.174	3.175	3.174	3.175	3.174	3.175	3.174	3.175	3.174	3.175
10	3.175	3.174	3.175	3.174	3.175	3.174	3.175	3.174	3.175	3.174	3.175	3.175
11	3.174	3.175	3.174	3.175	3.174	3.175	3.174	3.175	3.174	3.175	3.174	3.175
12	3.175	3.174	3.175	3.174	3.175	3.174	3.175	3.174	3.175	3.174	3.175	3.174
13	3.174	3.175	3.174	3.175	3.174	3.175	3.174	3.175	3.174	3.175	3.174	3.175
14	3.175	3.174	3.175	3.174	3.175	3.174	3.175	3.174	3.175	3.174	3.175	3.174
15	3.174	3.175	3.174	3.175	3.174	3.175	3.174	3.175	3.174	3.175	3.174	3.175
16	3.175	3.174	3.175	3.174	3.175	3.174	3.175	3.174	3.175	3.174	3.175	3.174
17	3.174	3.175	3.174	3.175	3.174	3.175	3.174	3.175	3.174	3.175	3.174	3.175
18	3.175	3.174	3.175	3.174	3.175	3.174	3.175	3.174	3.175	3.174	3.175	3.174
19	3.174	3.175	3.174	3.175	3.174	3.175	3.174	3.175	3.174	3.175	3.174	3.175
20	3.175	3.174	3.175	3.174	3.175	3.174	3.175	3.174	3.175	3.174	3.175	3.174
21	3.174	3.175	3.174	3.175	3.174	3.175	3.174	3.175	3.174	3.175	3.174	3.175
22	3.175	3.174	3.175	3.174	3.175	3.174	3.175	3.174	3.175	3.174	3.175	3.174
23	3.174	3.175	3.174	3.175	3.174	3.175	3.174	3.175	3.174	3.175	3.174	3.175

24	3.175	3.174	3.175	3.174	3.175	3.174	3.175	3.174	3.175	3.174	3.175	3.174
25	3.174	3.175	3.174	3.175	3.174	3.175	3.174	3.175	3.174	3.175	3.174	3.175
26	3.175	3.174	3.175	3.174	3.175	3.174	3.175	3.174	3.175	3.174	3.175	3.174
27	3.174	3.175	3.174	3.175	3.174	3.175	3.174	3.175	3.174	3.175	3.174	3.175
28	3.175	3.174	3.175	3.174	3.175	3.174	3.175	3.174	3.175	3.174	3.175	3.174
29	3.174	3.175	3.174	3.175	3.174	3.175	3.174	3.175	3.174	3.175	3.174	3.175
30	3.175	3.174	3.175	3.174	3.175	3.174	3.175	3.174	3.175	3.174	3.175	3.174
31	3.174	3.175	3.174	3.175	3.174	3.175	3.174	3.175	3.174	3.175	3.174	3.175
32	1.720	1.984	2.249	2.513	2.778	3.042	3.175	3.174	3.175	3.174	3.175	3.174
33	-	-	-	-	-	-	0.132	0.397	0.661	0.926	1.190	1.455

Table 2

General Depreciation System - Straight-Line Depreciation Method
39 Years Recovery Period, Mid-Month Convention
Real Estate Placed in Service After May 12, 1993

The depreciation rate is:
(use the column for the month in the first year the property is placed in service)

Recovery Year	Jan	Feb	Mar	Apr	May	June	Jul	Aug	Sept	Oct	Nov	Dec
1	2.461	2.247	2.033	1.819	1.605	1.391	1.177	0.963	0.749	0.535	0.321	0.107
2 - 39	2.564	2.564	2.564	2.564	2.564	2.564	2.564	2.564	2.564	2.564	2.564	2.564
40	0.107	0.321	0.535	0.749	0.963	1.177	1.391	1.605	1.819	2.033	2.247	2.461

Example: Basis for Office-in-Home
Mary purchased a home in January 2013 for $125,000. She began using her home for her Mary Kay business in January 2017. On that date, the home appraised at $130,000. Her business percentage of use is 12.5 percent. Her calculation for depreciation is:

Lesser of cost or fair market value of home	$125,000	
Less cost of land	- 25,000	
	$100,000	
Percentage used for business	x 12.5%	
Basis for office-in-home	$12,500	
First Year Depreciation percentage	x 2.461%	(per Table 2)
Depreciation expense	$308	

Part IV - Summary
Although depreciation for your office-in-home is included on Form 4562, it must be subtracted from the total on line 22 before you enter your total depreciation on line 13 of Schedule C. This is because your deduction for office-in-home depreciation is included on line 30 of your Schedule C.

Part V - Listed Property
This part is used for depreciation of "listed" property. If you have an automobile used in your business, the related depreciation is listed here. You can depreciate your auto only if you use the actual expense method of deducting auto expenses.

Section A – Depreciation and Other Information (See instructions below for passenger automobile limits.)

Line 25 – Special Deprecation Allowance
Please refer to the information in Part II of this section for a discussion of the special depreciation allowance. Enter the special depreciation allowance for all applicable listed property acquired during the calendar year 2017.

Line 26 & 27 Column (a) - Type of Property
List the property, such as vehicles, with vehicles being listed first.

Column (b) - Date placed in service: This is generally the date you either purchased the auto for business use or converted one you already owned to business use.

Column (c) - Business use percentage – The business use percentage of a car is determined by dividing the number of business miles at the end of the year by the total number of miles driven in a year.

Column (d) - Cost or other basis: Your basis is generally the price you paid for the auto minus any Section 179 expense you claimed.

Column (e) - Basis for depreciation: Multiply Column (d) by the percentage in Column (c).

Column (f) - Recovery Period: Autos are generally classified as 5-year property. If your business usage is less than 50 percent, then you must use the 5-year straight-line method. See example below.

Column (g) – Method/Convention: Enter the method of figuring your depreciation deductions. If you are using the modified accelerated cost recovery system, enter 200DB/HY. If you choose an alternate percentage, or if the business percentage is 50 percent or less, enter S/L.

Column (h) - Depreciation Deduction: Column (e) multiplied by the applicable MACRS percentage (see MACRS tables listed prior), subject to the applicable limitations.

Passenger Automobile Limits

Maximum deductions allowed by the IRS for passenger automobiles that are not Trucks and Vans.

Year Auto Placed in Service	1st Year Deduction Limit	2nd Year Deduction Limit	3rd Year Deduction Limit	4+ Year Deduction Limit
2004	$10,610*	$4,800	$2,850	$1,675
2005	$2,960	$4,700	$2,850	$1,675
2006	$2,960	$4,800	$2,850	$1,775
2007	$3,060	$4,900	$2,850	$1,775
2008	$10,960*	$4,800	$2,850	$1,775
2009	$10,960*	$4,800	$2,850	$1,775
2010	$11,160	$4,900	$2,950	$1775
2011	$11,060	$4,900	$2,950	$1,775
2012	$11,160	$5,100	$3,050	$1,875
2013	$11,160	$5,100	$3,050	$1,875
2014	$11,160	$5,100	$3,050	$1,875
2015	$11,160	$5,100	$3,050	$1,875
2016	$11,160	$5,100	$3,050	$1,875
2017	**$11,160**	**$5,100**	**$3,050**	**$1,875**

Maximum deductions allowed by the IRS for Trucks and Vans.**

Year Auto Placed in Service	1st Year Deduction Limit	2nd Year Deduction Limit	3rd Year Deduction Limit	4 + Year Deduction Limit
9/11/01 – 5/5/03	$7,960*	$5,400	$3,250	$1,975
5/6/03 – 12/31/03	$11,010*	$5,400	$3,250	$1,975
2004	$10,910*	$5,300	$3,150	$1,875
2005	$3,260	$5,200	$3,150	$1,875
2006	$3,260	$5,200	$3,150	$1,875
2007	$3,260	$5,200	$3,050	$1,875
2008	$11,160*	$5,100	$3,050	$1,875
2009	$11,160*	$4,900	$2,950	$1,775
2010	$11,160	$5,100	$3,050	$1875
2011	$11,260	$5,200	$3,150	$1,875
2012	$11,360	$5,300	$3,150	$1,875
2013	$11,360	$5,400	$3,250	$1,975
2014	$11,460	$5,500	$3,350	$1,975
2015	$11,460	$5,600	$3,350	$1,975
2016	$11,560	$5,700	$3,350	$2,075
2017	$11,560	$5,700	$3350	$2075

** If you decided **not** to claim any special depreciation allowance for the vehicle or the vehicle is not qualified property, the limit in the first year is as follows:*

Passenger Autos: $3,160 (2017)
Trucks & Vans: $3,560 (2017)

You may wish to consult your personal tax advisor in this matter.

***For purposes of the above depreciation deductions, the term "trucks and vans" refers to passenger automobiles that are built on a truck chassis, including minivans and sports utility vehicles (SUVs) that are built on truck chassis, and is rated at an unloaded gross weight of 6,000 pounds or less. Trucks or SUVs over this weight may qualify for additional deductions under certain circumstances. Please contact your personal tax advisor to discuss this matter further.*

These maximum deduction amounts include any combination of Section 179 expense, special depreciation allowance and depreciation expense.

These limitations of depreciation per year are further subject to proration between business and personal use. If qualified business use falls below 50 percent in any subsequent year, accelerated depreciation must be recaptured. See example below.

Example of Auto Depreciation

On July 1, 2017, Mary purchased and placed in service a $20,000 passenger auto, which is used 75 percent for qualified business purposes and 25 percent for personal use.

Purchase price of car	$20,000
Business percentage	x 75%
Business portion of car	$15,000
Less Section 179 amount	(0)
	$15,000
Allowance percentage	x 50%
Special depreciation allowance	$ 7,500

Purchase price of car	$ 20,000	
Business percentage	x 75%	
Business portion of car	$ 15,000	
Less Section 179 amount	(0)	
Less special depreciation allowance	(7,500)	
Basis for depreciation	$ 7,500	
First-year depreciation percentage	x 20%	(per MACRS 5-yr property table)
Depreciation	$ 1,500	

The maximum first-year depreciation Mary may take is $8,670. The calculation is the lesser of $9,000 (No Section 179 expense plus the $7,500 special depreciation allowance plus $1,500 depreciation, as calculated above) or $8,670 ($11,560 maximum allowed for auto placed in service in 2017 x 75% business use percentage).

Column (i) - Elected Section 179 Cost: Enter the amount you choose to expense for property used more than 50 percent for business. Be sure to include this on line 2 of Part I as well. You may wish to consult your personal tax advisor to discuss the implications of claiming the Section 179 deduction on an automobile.

Section B – Information on Use of Vehicles
Complete this section for the automobile used in your Mary Kay business. Your business percentage listed in Column (c) of Section A should agree with the information provided in this section.

Section C – Questions for Employers Who Provide Vehicles for Use by Their Employees
This section is not applicable to your Mary Kay business.

Part VI – Amortization
This section is not applicable to your Mary Kay business.

Form 8829—Expenses for Business Use of Your Home

To claim a deduction for business use of your home, you can use either simplified method or Form 8829, but not both. If you elect to use the simplified method, please see the discussion under Sch. C, Line 30.

A taxpayer may only deduct expenses of using her home for business purposes if they are attributable to a portion of the home that is used ***exclusively on a regular basis*** as:

1. The principal place of any business carried on by the taxpayer **and**

2. A place of business that is used by clients or customers in meeting or dealing with the taxpayer in the normal course of business.

Your home office may qualify as your principal place of business for deducting expenses for its use if:

1. You use it exclusively and regularly for administrative or management activities of your business.

2. You have no other fixed location where you conduct substantial administrative or management activities of your business.

For example, Pamela is an Independent Sales Director. She has an office in her home that she uses exclusively and regularly to set up appointments and write up orders and other reports for her business.

Pamela's business is selling products to customers at various locations, as well as building and motivating her unit. To make sales, she regularly visits customers to explain available products and take and deliver orders.

Pamela's home office qualifies as her principal place of business for deducting expenses for its use. She conducts administrative activities there and she has no other fixed location where she conducts administrative activities. Because she meets all the qualifications, including principal place of business, she can deduct expenses (to the extent of the deduction limit) for the business use of her home.

Independent Beauty Consultants and Independent Sales Directors whose sales and team-building businesses are conducted mostly in their homes, and who spend time in their home offices conducting administrative activities of their Mary Kay businesses, may qualify for this deduction.

You should consult your personal tax advisor to help you analyze your ability to qualify for a home-office deduction. Also, since this deduction will vary on a case-by-case basis **the Company strongly suggests you *not* advise potential team members or new Independent Beauty Consultants on the home-office deduction.**

What qualifies as a home office?
If you qualify for a home-office deduction, you are allowed to deduct the part of your home expenses that you can attribute to your Mary Kay business. This is true for a home you own, a home you rent, an apartment or a condominium. The business space in your home does not have to be a separate room or even a partitioned area, but it does have to be an area used exclusively and regularly. These terms are defined as:

> **Exclusive use:** This means you use a part of your home for nothing else but your business. If the same part of your home is used for any other purpose, you have not satisfied the exclusive use test. However, even if you do not meet the exclusive use test, you may still deduct expenses that relate to the part of your home used to store inventory. You may deduct ordinary and necessary expenses related to the storage space the same way as the home office, provided you use this space for Mary Kay storage on a regular basis and for no other purpose.
>
> **Regular Use:** Occasional or incidental business use will not qualify for this deduction, even if you pass the exclusive use test. Regular use means that you use the area of your home for business on a continuing basis.

Percentage of Your Home Used for Business
You can determine the percentage of business use of your home by dividing the square footage of the area you use for business by the total square footage of the residence.

You can determine the business portion of indirect expenses for maintaining and operating your home by multiplying the business percentage of use by the expense amount. For example, if your home contains 1,500 square feet and you have a 150 square-foot room that you use just for your business, the percentage of business use is 10 percent. Thus, if you repair your roof, you can deduct 10 percent of the cost of the repair.

The following items are the details of the home-office deduction. Remember this: If you have sufficient business income, you must deduct either all or none of your home office expenses. For example, if you deduct the costs of mortgage interest, taxes, and utilities, you must also deduct depreciation on your home.

Line-by-Line Instructions

<u>Part I - Part of Your Home Used for Business</u>

> **Line 1 -** Enter square footage of area used exclusively for business.
>
> **Line 2 -** Enter total square footage of your home.
>
> **Line 3 -** Divide line 1 by line 2 and enter as a percentage on line 3.
>
> **Line 7 -** Transfer number from line 3 to line 7.

Part II - Figure Your Allowable Deduction

Column (a) - Direct expenses benefit only the business part of your home. They include repairs made to the specific area or room used for business. Enter 100 percent of your direct expenses on the appropriate expense line in Column (a).

Column (b) - Indirect expenses are for keeping up and running your entire home. They benefit both the business and personal parts of your home. Generally, enter 100 percent of your indirect expenses in the appropriate expense line in column (b).

Line 24: Transfer amount from 2016 Form 8829 Line 42
Line 30: Transfer amount from 2016 Form 8829 Line 43

Part III - Depreciation of Your Home

See discussion on business use of your home under Form 4562.

Part IV - Carryover of Unallowed Expenses to 2018

Amounts reported on **Line 42 & Line 43** will be transferred to your 2018 Form 8829.

Form 1040-ES—Estimated Tax for Individuals

After completing your tax return, you should determine your need to make quarterly estimated tax payments for 2018. At the time of this publication, the 2018 Form 1040-ES and instructions were not available, therefore please go to *www.irs.gov/forms-instructions* had type in 2018 Form 1040-ES Instructions. The instructions will help you determine if you are required to make quarterly estimated payments. Please consult her personal tax advisor if you have any questions regarding estimated payments.

Related forms and publications that you may find helpful include IRS Publication 505 *Tax Withholding and Estimated Tax,* which provides detailed information regarding estimated tax payments. Form 2210 is used to determine the amount of an underpayment of taxes and to calculate any related penalties.

Schedule SE (Form 1040)

The Social Security Administration uses your Schedule SE (Form 1040) to determine your contributions and benefits under the Social Security program for self-employed persons. As an Independent Beauty Consultant or an Independent Sales Director, you must complete a Schedule SE if you can answer yes to the following question: On Schedule C, Part II, line 31, is your entry for net earnings $400 or more?

If you are required to file Schedule SE, enter the amount from line 31 of Schedule C on Section A, line 2 of Schedule SE and follow the instructions. For 2017, the self-employment tax rate is 15.3 percent of earnings up to 127,200. If you have earnings more than127,200, the excess amount is taxed at a 2.9 percent rate. One-half of the self-employment tax is deductible on Form 1040, line 27.