



DAN KNODL

STATE REPRESENTATIVE • 24TH ASSEMBLY DISTRICT

Senate Committee on Judiciary and Labor
Senate Bill 365
State Representatives Dan Knodl
October 29, 2013

Thank you Chair and Senate Committee members on having a hearing on Senate Bill 365 which updates and federalizes Wisconsin's existing exemption for direct sellers.

This update is extremely important to ensure that Wisconsin's 380,000 direct sellers, accounting for over \$600 million in annual sales, can maintain their independence. These people are usually our neighbors, relatives, and friends. They sell products for well-known producers such as Avon Products Inc., Amway, Mary Kay Inc., and Pampered Chef. These direct sellers are micro-entrepreneurs working part time to earn extra income.

The existing direct seller exemption was put into place in 1983. Since then, there has been a change in the way direct sellers conduct business. The issue stems from the current language in statute that states sales must occur "primarily in the home." As you know, in today's world direct sellers may conduct transactions at work or even at a coffee shop. This has caused confusion for both the department and the direct sellers when it comes to applying the definition to today's business.

Senate Bill 365 updates existing statute to mirror the language found in federal statute 26 U.S.C. § 3508. By doing this, we would be providing greater clarity and consistency to the business community and those involved in direct selling, and bring Wisconsin into conformity with how more than 30 other states treat this issue.

This legislation was presented to the Unemployment Insurance Advisory Council and they have stated they do not object to this bill pending a minor language change. This change will be reflected in a forthcoming amendment that is agreeable to all parties involved.

I would like to thank the committee for their time and I would be happy to entertain any questions that you may have.

October 29, 2013

To: Members of the Senate Committee on Judiciary & Labor
From: Senator Glenn Grothman
Re: Senate Bill 365

Senate Bill 365 was introduced to update and federalize Wisconsin's Unemployment Insurance exemption for direct sellers. Direct sellers are individuals that typically work part-time, setting their own hours, selling products for companies such as Pampered Chef, Avon, Mary Kay and Lia Sophia.

Presently, direct sellers conduct business in all types of venues and have many different methods for selling their products. They are sometimes contacted by individuals to hold events in their home or work, or they sell at larger events like county fairs and craft shows.

But, under current law, the sales must take place "primarily in the home" in order to be exempted from Unemployment Insurance. This outdated language has caused confusion for not only the business community, but also for state regulators.

SB 365 ensures that Wisconsin's direct selling law conforms to direct selling law in more than thirty other states, including Michigan and Iowa, and also to federal law. The bill makes certain that direct sellers are classified as independent contractors and not as employees. This change will lower the cost of doing business and will encourage expansion of the industry in Wisconsin.

Please join me in supporting this legislation that will allow for clarity and consistency in the direct selling business community.



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October 29, 2013

Members of the Wisconsin Senate Judiciary & Labor Committee

Re: Comments in support of SB 365 relating to direct sellers' unemployment compensation exemption

Dear Members of the Senate Judiciary & Labor Committee:

The Direct Selling Association ("DSA") would like to **voice its support of SB 365**. This bill would clarify Wisconsin's existing unemployment compensation exemption language for direct sellers under Wisc. Stat. Ann. § 108.02 (15)(k)(16), and ensure direct selling can continue to offer economic opportunities to all Wisconsin residents. It is important to note this bill is not a new law, but is simply a clarification of an existing statute.

In Wisconsin, as in the rest of the country, individuals selling for direct selling companies are independent contractors. These individuals typically sell on a part-time basis to their neighbors, relatives, and friends to supplement their family income. These direct selling companies, with over 15.9 million individual American direct sellers, include some of the nation's most well-known commercial names. The direct selling industry attracts individuals seeking job flexibility, offering low start-up costs to many who often have minimal work experience. Their direct selling activities are generally neither extensive nor sophisticated. Direct sellers are quintessential micro-entrepreneurs.

DSA and our over 175 member companies encourage this Committee to ensure the over 380,000 direct sellers in Wisconsin, accounting for over \$629 million in annual sales, maintain their independence by clarifying existing law to conform to the law in more than 30 other states (including Michigan, Iowa, Montana, Nebraska and Missouri) and federal law. While current Wisconsin law classifies direct sellers as independent contractors for unemployment compensation purposes, the language is outdated and when it is applied to direct sellers, can be confusing and lead to erroneous determinations of employment status. DSA proposes that Wisconsin amend its direct seller provision to conform to federal law and clarify the status of direct sellers.

DSA, on behalf of Wisconsin direct sellers, seeks this change because:

- This proposed direct seller provision is a non-substantive change in state law. It simply allows Wisconsin to conform to federal law and the majority of states. Direct sellers are currently independent contractors under the law in Wisconsin; however, this proposed language would provide clarity and consistency to the business community and state regulators.

- Current Wisconsin law is outdated and can lead to confusion and the inappropriate classification of direct sellers as employees rather than independent contractors.
- Direct sellers do not participate in the unemployment compensation system – they do not pay into the system and do not draw from it based on their direct selling activities because they are not employees.

DSA fully supports the proper classification of employees for purposes of unemployment compensation, a public policy concern we share. However, it is vital to clarify the current statutory language in order to ensure legitimate independent contractors working as direct sellers are not classified as employees for the purposes of unemployment compensation. For the foregoing reasons, **the Direct Selling Association respectfully asks you to vote “Yes” on SB 365.**

Sincerely,

A handwritten signature in cursive script that reads "M. Jeff Hanscom".

Jeff Hanscom
Attorney & Manager, Government Relations
Direct Selling Association



OFFICE OF
CHIEF COUNSEL

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224
June 11, 1999

Number: **199940006**
Release Date: 10/8/1999

UIL No. 3508.01-02
CC:EBO:2
COR-108721-99

Re: Service performed by a direct seller as defined in section 3508 of the Internal Revenue Code

Dear

This responds to your letter dated May 3, 1999, to _____, employment tax coordinator for the _____ District. _____ referred your letter to our office for a response.

You state that in _____ the _____ legislature passed legislation that provides for an exclusion of services performed by direct sellers for unemployment insurance purposes. _____ of the _____ states: “

” You request our assistance in providing federal policies, precedents, or rulings interpreting section 3508 of the Code.

We can provide the following general information, which we hope will be helpful to you.

Section 3508(b)(2) of the Code defines direct seller as follows:

(2) Direct Seller.—The term “direct seller” means any person if—

(A) such person—

(i) is engaged in the trade or business of selling (or soliciting the sale of) consumer products to any buyer on a buy-sell basis, a deposit-commission basis, or any similar basis which the Secretary prescribes by regulations, for resale (by the buyer or any other person) in the home or otherwise than in a permanent retail establishment,

(ii) is engaged in the trade or business of selling (or soliciting the sale of) consumer products in the home or otherwise than in a permanent retail establishment, or

(iii) is engaged in the trade or business of the delivering or distribution of newspapers or shopping news (including any services directly related to such trade or business),

(B) substantially all the remuneration (whether or not paid in cash) for the performance of the services described in subparagraph (A) is directly related to sales or other output (including the performance of services) rather than to the number of hours worked, and

(C) the services performed by the person are performed pursuant to a written contract between such person and the person for whom the services are performed and such contract provides that the person will not be treated as an employee with respect to such services for Federal tax purposes.

The Proposed Employment Tax Regulations further define direct seller in section 31.3508-1(c), (f), and (g).

Section 31.3508-1(c)(2)(i) provides that services described in paragraph (c)(2) are any services that customarily are directly related to the trade or business of selling or soliciting the sale of consumer products in the home or in any other location that does not constitute a permanent retail establishment. Such services may include any activity to increase the productivity of other individuals engaged in such sales, such as recruiting, training, motivating, and counseling such individuals. Except as provided in paragraph (c)(2)(ii), such services do not include the installation or construction on the customer's property of a consumer product.

Section 31.3508-1(c)(2)(ii) provides that if an individual engaged in the trade or business of selling consumer products performs installation services in conjunction with the sale of a consumer product, such services shall be included as services performed as a direct seller only if the value of such installation services is 10 percent or less of the purchase price of the consumer product (including installation).

Section 31.3508-1(f) provides that a person is not engaged in the trade or business of selling or soliciting the sale of consumer products if the sale or use of such products is in an incidental part of a trade or business in which such person primarily renders services to clients. Whether the sale or use of a product is an incidental part of a trade or business that primarily consists of rendering services shall be determined on the basis of all the facts and circumstances, taking into account such factors as the cost of the product in relation to the cost of the service. Generally, the sale or use of a product is an incidental part of a trade or business that primarily consists of rendering services if

the use of the product is necessary to the performance of the particular service (for example, insecticide in a pest control business).

Section 31.3508-1(g)(3) provides that the term "consumer product" means any tangible personal property which is distributed in commerce and which is normally used for personal, family, or household purposes, including any such property intended to be attached to or installed in any real property without regard to whether it is so attached or installed. The term "consumer product" does not include any product used in the manufacture of another product to be distributed in commerce or any product used only incidentally in providing a service (for example, insecticide used in a pest control business or materials used in an appliance repair business).

Whether certain workers are direct sellers for purposes of section 3508 has been litigated in three federal courts. In two cases, the definition of "consumer products" was at issue.

In the first of these cases, Cleveland Institute of Electronics, Inc. v. United States, 787 F. Supp. 741 (N.D. Ohio 1992), the court found that home study educational courses were consumer products and that the workers selling these products were direct sellers for purposes of section 3508. The government argued that consumer products were limited to tangible products, as stated in the proposed regulations. The court rejected this distinction between tangible and intangible consumer products, pointing out that it had been six years since the regulations were proposed and they had still not been issued in final form. The court instead relied on the purpose of the statute, as set forth in the legislative history to section 3508—to reduce the number of controversies regarding employment tax status and to increase compliance on the part of independent contractors. It found that these purposes were best served by interpreting the term consumer products to include both tangible consumer goods and intangible consumer services. We note that the Cleveland Institute opinion surveys both the legislative history of section 3508 and other federal statutes that use the term consumer products.

In the second case, R Corporation v. United States, 94 U.S. Tax Cas. (CCH) ¶ 50380 (M.D. Fla. 1994), after reviewing the opinion in Cleveland Institute, the court found that cable television subscriptions were consumer products and that the door-to-door sellers were direct sellers for purposes of section 3508.

In the third case, Smoky Mountain Secrets, Inc. v. United States, 910 F. Supp. 1316 (E.D. Tenn. 1995) the court found that telephone marketers and delivery persons (of gourmet foods and condiments) were direct sellers for purposes of section 3508, where the delivery persons collected payment and often closed the sale.

The IRS has acknowledged the courts' determinations regarding the definition of consumer products in its training materials (used to train revenue agents) entitled "Independent Contractor or Employee?" Training 3320-102 (Rev. 10-96) TPDS 84238I.

In commenting on the Cleveland Institute and R Corporation cases, the training materials state:

Based upon the litigation cited above, and pending finalization of the regulations and further consideration of this issue in that context, cases should not be developed based on a distinction between tangible and intangible products; i.e., both types of products will qualify. In your consideration of direct seller cases, care should be taken, therefore, to ensure that your research is current.

A copy of pages 3-17 and 3-18 from the training materials is enclosed for your information.

Many states have statutes that track the language of Code section 3508. You may find it helpful to review decisions of state courts interpreting those statutes. See, for example, Advanced Sports Info., Inc. v. Novotnak, 956 P.2d 806 (Nev. 1998) (where state statute was modeled after federal statute (Internal Revenue Code section 3508), court followed federal case law in finding that consumer products included intangible services as well as tangible goods); Kirby Center v. Dep't of Labor and Empl. Sec., 650 So. 2d 1060 (Fla. Dist. Ct. App. 1995) (telephone solicitors who set up appointments for salespeople were direct sellers under the Florida statute, given the plain meaning of the statute); Miles Homes, Div. of Insilco v. Schloeder, 407 N.W. 2d 479 (Minn. Ct. App. 1987) (home kit, comprised of pre-cut and measured building materials, was a consumer product and sales representative was a direct seller for purposes of state unemployment insurance benefits).

Similarly, federal courts have interpreted other federal statutes with similar language. You may find it helpful to compare the interpretations given to other statutes with the interpretations of section 3508. See, for example, Kemp v. Pfizer, Inc., 835 F. Supp. 1015 (E.D. Mich. 1993) (prosthetic heart valve was not a consumer product under the federal Magnuson-Moss Warranty Act, which defines consumer product as "any tangible personal property which is distributed in commerce and which is normally used for personal, family, or household purposes").

An individual worker or a firm for which the worker provides services may obtain a ruling from the IRS as to whether the worker is an employee for purposes of federal employment taxes by filing Form SS-8, Determination of Employee Work Status for Purposes of Federal Employment Taxes and Income Tax Withholding. A copy of Form SS-8 is enclosed. However, the IRS will not provide a ruling to anyone other than the worker or the firm for which the worker provides services.

We searched for IRS rulings addressing Code section 3508(b)(2) and found 90 items. Of those 90 items, 74 related to vacuum cleaner salespeople, and 16 related to other workers, such as providers of newspaper delivery services, sellers of home improvement items, sellers of insurance, and sellers of clocks and hearing aids. None

of the rulings related to mortgage brokers or mortgage solicitors. A list of representative rulings is enclosed.

We hope this information will be helpful to you. If you have further questions, you may contact Rebecca Wilson (badge No.) of this office at (202) 622-6040.

Sincerely,

Jerry E. Holmes
Chief, Branch 2
Office of Associate Chief Counsel
(Employee Benefits and
Exempt Organizations)

Enclosures (3)

"Independent Contractor or Employee?" Training 3320-102 (Rev. 10-96)
TPDS 84238I, pages 3-17 and 3-18.
Form SS-8, Determination of Employee Work Status for Purposes of
Federal Employment Taxes and Income Tax Withholding.
List of representative Code section 3508(b)(2) rulings.

cc: