



Direct Selling Industry – The Network Sellers Method for Network Sellers and Sales Representatives

This info sheet reflects proposed amendments to the *Excise Tax Act* announced on January 27, 2009. Any commentary in this info sheet should not be taken as a statement by the Canada Revenue Agency that the amendments will be enacted in their current form. The amendments are proposed to come into force for any fiscal year of a network seller that begins on or after January 1, 2010.

Businesses in the direct selling industry usually sell their products either directly to consumers through sales representatives or to independent sales contractors (ISCs) who, in turn, sell the products to purchasers.

In either case, direct selling businesses may apply for approval to use a method that simplifies the operation of the GST/HST:

- Direct selling businesses that sell their products to ISCs may apply to use the Alternate Collection Method.
- Direct selling businesses that sell their products to consumers through commission-based sales representatives may apply to use the Network Sellers Method.

Depending on their business structure, they may qualify to use one or both methods.

The Alternate Collection Method (ACM) is available to businesses in the direct selling industry that sell their products to distributors or ISCs who, in turn, sell the products to other ISCs or to purchasers. The ACM rules will be explained in the GST/HST Info Sheet, *Direct Selling Industry – The Alternate Collection Method for Direct Sellers and Distributors*.

The Network Sellers Method (NSM) is available to businesses in the direct selling industry that sell their products to consumers through sales representatives who charge a commission for arranging for the sales

of the products. In this info sheet, these businesses are called network sellers.

This info sheet explains the approval process, the NSM rules that apply to network sellers and sales representatives, and the documentary evidence that they have to keep.

Meaning of significant terms used in this info sheet

“All or substantially all” means 90% or more.

“Consumer” means an individual who purchases a select product of a network seller for the individual’s own use or enjoyment, or for the personal use or enjoyment of another individual at the consumer’s expense.

“Fiscal year” means the taxation year of a network seller unless it has elected to use a calendar year.

“Network commission” means an amount payable by a network seller to a sales representative under an agreement:

- as payment for the sales representative’s service of arranging for the sale of select products or sales aids of the network seller; or
- solely because another sales representative of the network seller arranged for a sale of a select product or sales aid.

“Sales aid” is a customized business form or a sample, demonstration kit, promotional or instructional item, catalogue or similar personal property acquired, manufactured or produced by a network seller or a sales representative for sale to assist in the promotion, sale or distribution of select products. A sales aid does not include a select

product or property that a sales representative will be using as capital property.

“Sales representative” of a network seller is a person that has an agreement with the network seller:

- to arrange for the sale of select products of the network seller, but does not arrange for those sales primarily (more than 50%) at a fixed place of business, except if it is the person’s home; or
- to be paid an amount by the network seller solely because another sales representative of the network seller arranged for a sale of a select product or sales aid.

Sales representatives do not purchase products for resale. They receive a commission as payment for their services of arranging for the sale of a network seller’s products or solely because another sales representative arranged for a sale of a product or a sales aid.

An employee of the network seller or an agent who sells products on behalf of the network seller is not a sales representative for the purposes of the NSM. For more information on agents, see GST/HST Info Sheet GI-012, *Agents*.

“Select products” are goods acquired, manufactured or produced by a network seller for sale in the ordinary course of its business and that are ordinarily purchased by a consumer. Used goods are not select products.

“Taxable” means subject to the 5% GST or to the HST rate in effect in a particular province. “Zero-rated” means subject to the GST/HST at 0%.

The NSM

Network sellers usually sell their select products to consumers through sales representatives who charge a network commission for their services of arranging for the sale. Registrant sales representatives are required to charge and account for the GST/HST on their network commissions.

A network seller may apply for approval to use the NSM. The main effect of the NSM for network sellers is that, when an approval is in effect, the network commissions charged by a sales

representative to a network seller are not subject to GST/HST.

Approvals for the NSM apply in respect of any fiscal year that begins on or after January 1, 2010.

Eligibility requirements

A registered network seller may apply to the CRA for approval to use the NSM if, throughout the fiscal year, the network seller reasonably expects that:

- (a) all or substantially all of its total revenues for the fiscal year for sales made in Canada from a business will be for sales of select products arranged for by sales representatives, or if the network seller is an approved direct seller for the ACM, for sales of exclusive products to ISCs;
- (b) all or substantially all of its total revenues from a business for sales of select products arranged by sales representatives for the fiscal year will be for sales of select products to consumers;
- (c) all or substantially all of the sales representatives to whom it pays network commissions during the fiscal year will receive \$30,000 or less in network commissions. If the fiscal year has less than 365 days, the \$30,000 has to be prorated as follows:

$$\frac{\text{Number of days in the fiscal year} \times \$30,000}{365 \text{ days}}$$

and

- (d) it will be engaged exclusively in commercial activities throughout the fiscal year.

In addition, the network seller must have made a joint election with each of its sales representatives to have the NSM apply at all times when an approval is in effect.

Joint election

The joint election between a network seller and each of its sales representatives must be made before the network seller applies for approval to use the NSM. The election must be made with all sales representatives, including those who receive a network commission solely because another sales representative arranged for a sale of a select product or sales aid. It must also be made with persons who

become sales representatives while an approval to use the NSM is in effect.

The joint election must be made in writing, but it does not have to be filed with the CRA. No special form has to be completed, but the election must include the information set out in Appendix A to this info sheet. Appendix A is an example of a joint election acceptable to the CRA that could be used when a network seller elects with its sales representatives.

As an alternative, the CRA would also accept a joint election that forms part of the agreement that a network seller enters into with its sales representatives. To be an election, the agreement must specify that the sales representative jointly elects with the network seller to have the NSM rules apply to network commissions at all times when an approval granted to the network seller is in effect.

Keeping records

Network sellers and sales representatives must keep in their records evidence of their joint elections. In addition, a network seller must keep and maintain an up-to-date list or database containing the names of each sales representative with whom it has made an election, including the beginning and end dates of each election (i.e., the date the election was made and the date the sales representative ceased its activities as a sales representative, if applicable). Detailed information on books and records is available in GST/HST Memoranda 15.1, *General Requirements for Books and Records*, and 15.2, *Computerized Records*.

Application to use the NSM

A registered network seller may apply to the CRA for approval to use the NSM before the first day of its fiscal year to have the NSM apply effective on that day.

The application must be sent to the Assistant Director of Audit at the tax services office closest to the network seller. No special form has to be completed, but the application must contain the information set out in the Appendix B to this info sheet.

Appendix B is an example of an application acceptable to the CRA that could be used when a network seller applies to use the NSM.

Notification of approval or refusal

The CRA will notify the network seller in writing of the approval or refusal to use the NSM.

If the approval is granted, the network seller must inform its sales representatives that it has been approved by the CRA to use the NSM and indicate the effective date of that approval. This could be done by providing current and future sales representatives with a copy of the approval letter or by uploading a scanned copy of the approval on the organization's Web site. The scanned document should be capable of being printed. The network seller may also provide current and future sales representatives with a document indicating that the network seller has been approved by the CRA and indicating the effective date of the approval.

If the application is refused, the network seller must immediately notify all its sales representatives. The notification may be made in writing or electronically if the electronic document can be printed.

Approval required when purchasing a network seller's business

Depending on the circumstances, when a network seller sells its business or part of its business, the approval to use the NSM does not necessarily pass to the new owner of the business or part of the business. If the new owner wants to use the NSM, it should contact the CRA to determine if it has to apply for approval.

The NSM rules

When approval to use the NSM is granted to a network seller, the NSM rules apply to all sales representatives within the organization, whether or not they are registrants. This includes those who receive a network commission solely because another sales representative arranged for a sale of a select product or a sales aid.

The following rules apply when an approval to use the NSM is in effect.

Network commissions

GST/HST does not apply to a taxable service provided by a sales representative for which the sales representative receives a network commission from a network seller.

Example

A network seller that uses the NSM sells a variety of food products to consumers in Alberta. Some of the products are taxable while others such as spices and condiments are zero-rated.

A sales representative receives a commission for each sale of products arranged for the network seller. The sales representative's commissions are not subject to tax regardless of whether the commissions relate to taxable or zero-rated products.

Sales aids

Sales aids sold in Canada by a network seller or one of its sales representatives to another sales representative of the network seller are not subject to tax. In other words, GST/HST does not apply to sales aids sold to a sales representative.

This rule does not apply to sales aids sold to any other purchaser by either a network seller or a sales representative.

Example

A network seller that uses the NSM sells cosmetics and beauty products to consumers. A sales representative receives a commission for each sale arranged for the network seller. The network seller sold the sales representative a demonstration kit that is a sales aid. Later, the sales representative sold the kit to a consumer.

The NSM rules apply to sales aids sold by a network seller to a sales representative. Therefore, GST/HST did not apply when the network seller sold the demonstration kit to the sales representative. However, the NSM rules do not apply to sales of sales aids to consumers. Therefore, the sales representative, if a registrant, has to charge and account for the tax on that sale.

Host gifts

Host gifts given by a sales representative to an individual for acting as a host at an occasion that is organized for the purposes of allowing the sales representative to promote the sale of select products or to arrange for such sales are not subject to tax. Therefore, GST/HST does not apply when a sales representative gives a host gift to a host.

However, GST/HST applies to the sale of a host gift to a sales representative.

Example

A network seller that uses the NSM sells pet food to consumers. A sales representative arranges for the sale of the pet food through demonstrations in private houses and receives a commission for each sale he arranges for the network seller. For hosting a demonstration, an individual receives a gift. GST/HST does not apply to the host gift that the sales representative gives to the host.

Other rules

The NSM includes other rules that may have an impact on the network seller's business. Call GST/HST Rulings at 1-800-959-8287 for more information on:

- the network seller's entitlement to claim input tax credits when the network seller provides property (other than a select product) or a service to a sales representative or a sales representative's relative; and
- the network seller's obligation to charge and account for GST/HST on the fair market value of some property and services appropriated by the network seller for the benefit of a sales representative or a sales representative's relative.

<p>Note: Sales of select products by network sellers to consumers and others continue to be subject to the general GST/HST rules. Therefore, GST/HST applies to sales of select products (other than zero-rated select products).</p>
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Effects of the NSM on the business of a sales representative

As a result of the NSM rules, sales representatives do not include their network commissions and revenues from their sales of sales aids to other representatives in their calculation to determine whether they are small suppliers. Consequently, most sales representatives do not need to register for GST/HST purposes.

Sales representatives engaged in other activities

Sales representatives may be engaged in other activities. They may, for example, be a sales representative for a particular direct selling business and an ISC for another. For each activity, they have to determine separately how GST/HST applies,

keeping in mind that the NSM rules apply solely to their activities as a sales representative.

Example

An individual proprietor works from her home for two direct selling businesses. The first business, a network seller that uses the NSM, sells women's clothing to consumers. The individual, as a sales representative, receives a commission for each sale that she arranges for the network seller.

The second business sells children's toys. The individual, as an ISC, purchases the products from the direct selling business and sells them to consumers.

For each activity, the individual has to determine how GST/HST applies. With respect to her activities as a sales representative, she determines that, because the network seller uses the NSM, GST/HST does not apply to the commissions that she receives from the network seller. Because GST/HST does not apply to her commissions, she does not include them in her calculation to determine if she has to register for GST/HST purposes.

For her activity of buying and selling the children's toys, she determines that the sales are subject to the normal GST/HST rules. She includes the revenues from those sales in her calculation to determine if she has to register for GST/HST purposes.

Failure to meet the eligibility requirements while an approval is in effect

There are consequences when a network seller fails to meet all of the conditions included in paragraphs (a) to (c) of the eligibility requirements (see under the heading Eligibility requirements) for a fiscal year and, at any time during that year, a network commission is payable to a sales representative. In determining its net tax for its first

reporting period following the fiscal year, a network seller must add an amount equal to interest at the prescribed rate, on the total amount of tax that would have been payable on the network commissions, computed for the period:

- beginning on the earliest day on which the commission is paid or becomes due; and
- ending on the day on or before which the network seller is required to file a return for the reporting period that includes that earliest day.

The prescribed interest rates on overdue amounts can be found at www.cra.gc.ca/interestrates.

The amount equal to interest has to be included on line 104 of the network seller's GST/HST return.

Revocation of the approval

The Minister may revoke an approval to use the NSM if the network seller fails to comply with any GST/HST provision. The Minister may also revoke an approval at the network seller's written request. If the CRA revokes an approval, the network seller is required to notify immediately all of its sales representatives.

Call GST/HST Rulings at 1-800-959-8287 for information on the impact of a revocation on sales representatives and the adjustment that the network seller is required to make to its net tax if it fails to notify its sales representatives when an approval is revoked.

This info sheet does not replace the law found in *the Excise Tax Act* (the Act) and its regulations. It is provided for your reference. As it may not completely address your particular operation, you may wish to refer to the Act or appropriate regulation, or contact any CRA GST/HST rulings office for additional information. A ruling should be requested for certainty in respect of any particular GST/HST matter. Pamphlet RC4405, *GST/HST Rulings – Experts in GST/HST Legislation*, explains how to obtain a ruling and lists the GST/HST rulings offices. If you wish to make a technical enquiry on the GST/HST by telephone, please call 1-800-959-8287.

If you are located in Quebec and wish to make a technical enquiry or request a ruling related to the GST/HST, please contact Revenu Québec by calling 1-800-567-4692. You may also visit their Web site at www.revenu.gouv.qc.ca to obtain general information.

All technical publications related to GST/HST are available on the CRA Web site at www.cra.gc.ca/gsthsttech.

Appendix A

The following is the information that network sellers and their sales representatives must provide when they make a joint election to have the NSM apply at all times when an approval granted to the network seller is in effect.

JOINT ELECTION TO USE THE NETWORK SELLERS METHOD (NSM)

Information on network seller

Business Number RT

Legal Name

Contact Person

Title

Information on sales representative

Business Number (if applicable) RT

Complete Name (if individual)

Legal Name (if business)

Telephone Number

Contact Person

By signing this document, we jointly elect to have the NSM rules apply to network commissions at all times when an approval granted to the network seller is in effect.

We understand that this election is not valid if the application by the network seller to use the NSM is refused.

Certification – Network seller

I hereby certify that the information given in this election, and any document attached, is true, correct and complete to the best of my knowledge and that I am authorized to sign on behalf of the network seller.

Signature of authorized representative of network seller

Title of authorized representative

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Printed name

Date (YYYY-MM-DD)

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Certification – Sales representative

I hereby certify that the information given in this election, and any document attached, is true, correct and complete to the best of my knowledge and that I am the sales representative or I am authorized to sign on behalf of the sales representative.

Signature of sales representative or of a person
authorized to sign on behalf of sales representative

Title (if signed by authorized person)

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Printed name

Date (YYYY-MM-DD)

|

Appendix B

The following is the information that a network seller must provide when applying for approval to use the NSM.

APPLICATION TO USE THE NETWORK SELLERS METHOD (NSM)

Information on network seller's business

Business Number RT

Legal Name

Trading Name (if different)

Address

Telephone Number

Contact Person

Title

We would like this approval to be effective on (YYYY-MM-DD)

Number (or estimated number) of sales representatives marketing our select products:

Eligibility requirements (check the box if the condition has been met)

On behalf of the network seller, we certify that:

- we are registered for GST/HST purposes;
- the requested effective date of the approval is the first day of our fiscal year;
- we reasonably expect that we will be engaged exclusively in commercial activities throughout the fiscal year;
- we reasonably expect that all or substantially all of our total revenues for the fiscal year for sales made in Canada will be for sales of select products arranged for by sales representatives, or if we are an approved direct seller for the purposes of the Alternate Collection Method, for sales of exclusive products made by independent sales contractors;
- we reasonably expect that all or substantially all of our total revenues for sales of select products for the fiscal year will be for sales of select products made to consumers;
- we reasonably expect that all or substantially all of our sales representatives to whom we pay network commissions during the fiscal year will receive \$30,000 or less in network commissions;
- we have jointly elected with each of our current sales representatives.

We undertake to immediately enter into joint elections with any future sales representatives if approval to use the NSM is granted.

(continued on next page)

APPLICATION TO USE THE NETWORK SELLERS METHOD (NSM) (continued)

On behalf of the network seller, we confirm that we will:

- give our current and future sales representatives evidence that the CRA granted the network seller the approval to use the NSM and the effective date of that approval. We will either provide a copy of the CRA's approval letter or upload a scanned copy of the approval on our Web site, or we will provide a document indicating that the network seller has been approved by the CRA and indicating the effective date for the approval;
- provide written notification to our sales representatives if this application is refused. We will only notify our sales representatives electronically if the electronic document can be printed;
- keep evidence of the elections made jointly with each of our sales representatives; and
- keep and maintain an up-to-date list or database containing the names of each sales representative with whom we made a joint election, including the beginning and end dates of each election (i.e., the date the election was made and the date the sales representative ceases its activities as a sales representative, if applicable).

In addition, we are aware that there are consequences if, at any time during a fiscal year, a commission is payable to a sales representative and if, throughout the fiscal year, we do not satisfy the following conditions:

- all or substantially all of our total revenues for the fiscal year for sales made in Canada are for sales of select products arranged for by sales representatives, or if we are an approved direct seller for the ACM, for sales of exclusive products to independent sales contractors;
- all or substantially all of our total revenues for sales of select products arranged by sales representatives for the fiscal year are for sales of select products to consumers; and
- all or substantially all of our sales representatives to whom we pay network commissions during the fiscal year receive \$30,000 or less in network commissions (prorated if the fiscal year does not have 365 days).

We understand that any approval to use the NSM may be later revoked if:

- we fail to comply with any GST/HST provision;
- we request cancellation of our registration or receive notification of the cancellation of our registration; or
- it is reasonably expected that throughout the fiscal year:
 - we will no longer be engaged exclusively in commercial activities; or
 - we will no longer meet the eligibility requirements for approval.

We also understand that, if the approval is later revoked and we fail to notify our sales representatives, we will have to add an amount as an adjustment to our net tax calculation.

Certification

I hereby certify that the network seller has met the eligibility requirements for the application to use the NSM as provided in section 178 of the *Excise Tax Act*. I also certify that the information given on this application, and any document attached, is true, correct and complete to the best of my knowledge and that I am authorized to sign on behalf of the network seller.

Signature of authorized representative of network seller

Title

|

Printed name

Date (YYYY-MM-DD)

|