

**Office of the
Attorney General**

Pyramids, Gift Schemes & Network Marketing



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INTRODUCTION

Pyramid schemes are among the oldest and most common consumer scams. While pyramid schemes may be disguised as “gift” programs or “networking” plans, they have certain things in common. Pyramids are illegal. Pyramids will fail. People will lose money.

Network marketing companies (also called multi-level marketing companies), on the other hand, are lawful and legitimate businesses. The challenge is determining whether a particular plan is a legitimate multi-level marketing opportunity or an illegal pyramid scheme.

My office has prepared this brochure to help you understand the differences between legal and illegal business plans. I hope it is helpful. If you have additional questions, please contact my Consumer Protection Unit.

Sincerely,

LAWRENCE G. WASDEN
Attorney General

PART I: ILLEGAL PYRAMIDS

What is a Pyramid Scheme?

A pyramid scheme is an illegal moneymaking venture. The name comes from the pyramid shaped structure of the scheme. In a typical pyramid scheme, a few participants at the top of the pyramid recruit new participants for the bottom. The new recruits pay money to enter the scheme and must recruit additional participants to keep the pyramid alive. A pyramid scheme simply circulates money among participants. It does not create new wealth.

Although a few people might come out ahead, many more will lose money when the pyramid collapses. As the pyramid expands, it requires recruiting new members at a geometrically expanding rate.

Because there are only so many people in the world, it is mathematically impossible for pyramid schemes to continue indefinitely. A pyramid that is built when each participant gets six other people to join would require 10,077,696 participants at the ninth level!

Idaho law prohibits all pyramid schemes because they deceive and cheat consumers.

Pyramid Reality

Pyramids are illegal. There is a real risk that law enforcement authorities will shut down a pyramid scheme. Participants can be fined and arrested.

Pyramids are deceptive. Whether they intend to or not, participants in a pyramid deceive those they recruit. Few people would be fooled into joining if the risks were fully explained.

Pyramids are losers. Pyramids are based on simple mathematics: many losers pay a few winners.

Legal Consequences

Promoting or participating in a pyramid scheme violates the Idaho Consumer Protection Act. It is also a felony in Idaho. By participating you could end up with a criminal record. In Idaho, a felony crime is punishable by up to 5 years in prison, a fine of up to \$50,000, or both. Violators of the Consumer Protection Act are subject to civil penalties of \$5,000 per violation.

PART II: “GIFT” PYRAMIDS

Pyramid schemes have been “packaged” in different ways at different times. In recent years, promoters have described their pyramid schemes as “gifting programs.”

Some have falsely claimed that the Attorney General’s Office has approved their scheme. In fact, the Attorney General’s Office has never approved any business opportunity. If anyone tells you his or her plan is approved by the Attorney General’s Office, you should a) assume the plan is a scam and b) report the misrepresentation to the Consumer Protection Unit.

The Pitch

Usually a relative, friend or acquaintance will approach you with an “opportunity” to help yourself and those you care about. They will tell you that you can reduce your financial burdens simply by making one monetary "gift." In return, you'll be told that you will receive many times the amount of your initial gift. Often you will be told that some portion of the money will benefit a good cause. Don't fall for it. It is illegal. The odds are that you and your friends will lose money. If it sounds too good to be true, it probably is.

Pyramid promoters take advantage of group psychology. They often hold recruiting meetings where they create a frenzied, enthusiastic atmosphere. They use peer pressure and promises of easy money to play on people's greed. They warn that you could miss out on the deal of a lifetime.

It is Not a Gift

Although payments in pyramid schemes are often referred to as "gifts," in reality they are not gifts because the “giver” expects to receive much more money.

Many pyramid promoters claim that Internal Revenue Service code concerning monetary gifts supports their contention that the program is legal. Do not believe these claims. If you have questions about their legality, call the IRS Support Line at (800) 426-4741.

While it is legal to give monetary gifts of up to \$10,000 without causing a taxable event, true gifts are given with no strings attached and with no expectation of something in return. That is not the case with "gift" schemes. Such payments are taxable income. Furthermore, misrepresenting the nature of the payment is deceptive and violates Idaho law.

PART III – NETWORK OR MULTI-LEVEL MARKETING

“Network Marketing” Companies

Legitimate network (or multi-level) marketing companies differ from pyramid schemes because they generate new wealth through the sale of goods and services to non-participants. Pyramids, by contrast, depend on re-circulating the money of new participants. While network marketing companies and pyramids use the same organizational structure, network marketing companies are designed to sell products, rather than participation.

A network marketing company whose primary emphasis is to build a sales force rather than to sell the company’s products to customers outside the company may be an illegal pyramid scheme.

The Difference Between Pyramid Schemes and Network Marketing

Because pyramid promoters know that pyramid schemes are illegal, many try to disguise their schemes as legitimate network marketing companies by offering a line of

products and claiming to be in the business of selling them. This can make it difficult, at times, to distinguish between an illegal pyramid scheme and a legitimate network or multi-level marketing opportunity. To discern the difference, it is often necessary to carefully analyze the way the company is marketed and the way it does business.

In some cases, for example, the product may be worthless, something no one would buy except as a reason to participate in the scheme. Or, the product may be over priced. This price premium is actually a hidden pyramid scheme participation fee.

In other cases, the product may have some value but new participants are encouraged to buy larger amounts than they can sell in order to meet high sales quotas. This practice is known as “inventory loading.” Sometimes the participation fee may be disguised as expensive “training.”

In pyramid schemes, the emphasis is on building up the organization and the number of participants, not selling the products to customers. Pyramid schemes depend on making money from the participants rather than from sales to those outside the company.

Questions to ask yourself:

- Are you being pressured to make a hasty decision? If so, it may be a pyramid scheme. A legitimate network marketing opportunity will still be available next week.

- Could you make money by selling the product to customers, without recruiting anyone to sell for you? If not, it may be a pyramid scheme. Pyramids emphasize recruiting over selling. Network marketing emphasizes selling.
- Are training materials and other sales aids provided to you at cost? If not, it may be a pyramid scheme. If the company is truly interested in product sales, it will make money from your sales rather than from your training.
- How long has the company been in business? There is a very high failure rate among all new businesses. However, a number of new ventures claiming to be network-marketing companies fail because they are really disguised pyramid schemes and, consequently, collapse.
- Does the company require you to certify that you have sold most of your previous inventory before it sells you new products? If not or if you are encouraged to “fudge” the figures, it may be a pyramid scheme. Legitimate network marketing companies don’t load you up with inventory.
- Will the company repurchase your unsold inventory for at least 75 percent of your cost? If not, it may be a pyramid scheme. Read the fine print carefully. Ask to talk with someone who has actually returned inventory to the company.

- Is the emphasis on recruiting or on product sales? If it's on recruiting, the company may be a pyramid scheme. Even with a network structure, a multi-level company still needs to sell products to customers in order to succeed. In established network or multi-level companies, only a small percentage of the distributors actually build sales organizations.
- How many people are already signed up as marketing representatives in your area? Too many representatives in one area can saturate markets. If the company is already recruiting heavily in your area, how likely is it that you will be successful recruiting additional representatives?
- Are you told that people are making lots of money with only minimal effort and that you can too? If so, it may be a pyramid scheme. While network marketing may be a good business opportunity for the right person, it is not a get-rich-quick scheme.

Network or multi-level marketing can be a legitimate way for you to acquire products. It can also be a way to build your own business. But in a crucial way it is the same as most businesses. Success comes only with hard work. There is no shortcut to wealth.

Remember, pyramids are illegal. Network marketing companies are legal. If you have any doubt about whether a business opportunity is an illegal pyramid, you should contact the Consumer Protection Unit or consult a private attorney before you participate.

CONCLUSION

Do not be pressured into joining a pyramid scheme. Once you turn over your money it is very difficult - if not impossible - to recover it.

If you have questions about pyramids please call (208) 334-2424 or, toll-free 1-800-432-3545, TDD access is available.

Or, contact us by mail:

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The Consumer Protection Unit enforces Idaho's consumer protection laws, provides information to the public on consumer issues, and offers an informal mediation process for individual consumer complaints.

If you have a consumer problem or question, please call 208-334-2424 or in-state toll-free 1-800-432-3545. TDD access and Language Line translation services are available. The Attorney General's web site is available at www.ag.idaho.gov.