

# **Self-Employment and Social Security Disability Benefits 2011**

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## **INTRODUCTION**

There are several important reasons why the WIPA national training manual includes an entirely separate unit on the effect of self-employment income (SEI) on SSA disability benefits. First, SSA treats self-employment income differently from wages in both the SSI and Title II disability programs in some important ways and CWICs need to be aware of these critical differences. Secondly, there are several unique work incentives that apply to self-employed individuals which would not be applicable to individuals who are in wage employment. In addition, some work incentives that apply in both wage employment and self-employment situations are applied differently when the beneficiary is self-employed. Beneficiaries who are pursuing a goal of self-employment or small business ownership will need to be counseled on the unique manner in which disability benefits are affected by self-employment income and the ways in which work incentives may be applied to help achieve a self-employment goal.

Self-employment is an increasingly popular employment objective for individuals with disabilities since it offers both significant flexibility as well as earnings potential. State VR agencies and ENs are supporting a growing number of beneficiaries who are pursuing a self-employment goal and the volume of WIPA referrals on self-employment cases has also increased significantly in the past few years. Now more than ever, CWICs need to develop specific expertise in handling self-employment cases and must be skilled at counseling self-employed beneficiaries on benefits issues.

## **DETERMINING WHEN A BENEFICIARY IS SELF-EMPLOYED, IN WAGE EMPLOYMENT, OR NOT ENGAGED IN EMPLOYMENT AT ALL**

Some beneficiaries receive income related to an activity they perform, but they are unclear about whether or not this income counts as “wages”, “net earnings from self-employment” (NESE), or “unearned income” for Social Security purposes. Even when the income received is clearly

“earned” (meaning it is received in exchange for some type of work performed), it is sometimes difficult to determine if the income is from wage employment (i.e., an employer-employee relationship exists) or if the person is actually self-employed. Before a CWIC can offer advice about how a type of income would potentially affect disability benefits, it is essential that the CWIC be clear on how SSA would categorize that income – is it wages, is it self-employment income, or is it neither?

Determinations about whether income is “earned” as opposed to “unearned” and subsequent decisions about whether earned income represents “wages” or should be counted as “net earnings from self-employment” (NESE) can get very complicated. To make matters worse, these issues are not simply under the jurisdiction of the Social Security Administration. Both the U. S. Department of Labor (DOL) and the Internal Revenue Service (IRS) have a stake in these matters and often have overlapping laws and regulations. These determinations are critically important, since the SSA disability benefit programs treat various forms of income in very different ways.

When a beneficiary reports work activity and there does not seem to be an indication of wage employment (i.e., no employer-employee relationship exists), SSA must determine if the work represents self-employment (meaning a business exists) or is merely activity performed while pursuing a hobby. This distinction is very important! The buying and selling involved with a hobby is generally done for the purpose of improving or otherwise furthering the hobby. In these cases, the activities do not constitute a trade or business and income derived from pursuing a hobby would NOT be considered to be earned income by either the SSA or the IRS. This clearly would have implications for SSA disability benefits (both SSI and the Title II disability programs) and would affect a person’s tax liability. To make this determination, the SSA asks the following questions:

- Is there a good faith intention of making a profit or producing income?
- Is there continuity of operations, repetition of transactions, or regularity of activities?
- Are the functions being performed a regular occupation or profession?
- Is the beneficiary holding him/herself out to others as being engaged in the selling of goods or services?

With these questions, the SSA is looking for an overall pattern. One ‘yes’ answer to these questions is insufficient to make a determination of self-employment as opposed to pursuing a hobby. On the other hand, these questions need not all be answered with “yes” for self-employment to be determined to exist.

SSA typically considers an individual to be engaged in a trade or business as a self-employed person when he/she is regularly engaged in an occupation or profession for the purpose of deriving a livelihood, whether in whole or in part. The factors of continuity of work and profit motive indicate the existence of a trade or business even though there may be no “holding out” of the goods or services as available to the general public. Some other factors that come into play when considering the existence of a trade or business include:

- **Personal Services** -- The fact that an individual derives his/her income from a trade or business is the controlling issue - not the nature or extent of the services.
- **Seasonal** -- Although length of time is usually an important factor, certain activities that are considered to be a trade or business are seasonal (e.g., selling ice cream during the summer months, plowing snow during the winter).
- **Illegality** -- Even though an activity is illegal, it may still constitute a trade or business. Individuals engaged in such activities are required by SSA to report their income and pay self employment taxes.
- **Multiple Enterprises** -- An individual may have more than one trade or business at the same time. On the other hand, an individual may have more than one business enterprise, but one or more may be excluded from the definition of “trade or business”.

CWICs must remember that determining when activity represents a business as opposed to a hobby is something only SSA can do. If there is any doubt, CWICs are advised to refer the beneficiary to the local Social Security Field Office for clarification. In some case, SSA will rely on the IRS to make the final determination.

## **TYPES OF SELF-EMPLOYMENT**

Part of the process of determining when a beneficiary is self-employed involves deciding what type of self-employment the individual is engaged in or plans to be engaged in. These classifications are important because different forms of self-employment may be treated in different ways by the Social Security Administration. Determining which form of self-employment a beneficiary is participating in can get very complicated so when in doubt, refer the case to the local SSA Field Office for assistance. The most prevalent types of self-employment are described below, but CWICs need to understand that myriad different situation may occur which will have to be investigated on a case-by-case basis before a determination can be made.

### **Small Business Ownership**

This is perhaps the most common form of self-employment and is the easiest to identify. Small business ownership occurs when a beneficiary owns all or part of a business or micro-enterprise and derives earned income by performing services for that business. Small businesses may assume myriad forms and can be organized under a number of structures including sole proprietorship, partnership, limited liability companies, and corporations. A beneficiary may be the only owner of a company or business, or may be one of a number of owners. An individual who owns a share of a business is only considered to be self-employed for SSA purposes when some form of work or service is performed for that business. It is possible to be an investor in a business but not to be considered self-employed or receiving earned income, depending on what role the person plays within the business. There are some very complicated rules that apply to businesses which are incorporated that are explained a bit further on in this unit.

## **Independent Contractors**

Some people perform work through contracts with business or other entities rather than functioning as employees. Independent contractors are not employees, but rather constitute a specific type of self-employment. In determining whether an individual is an employee or an independent contractor under the common law rule, all evidence of control and independence must be considered. The facts fall into three main categories:

- does the entity have the right to direct and control how the worker performs the specific task for which the worker is hired;
- does the entity have the right to direct and control the business and financial aspects of the worker's activities; and
- the relationship of the parties. A written contract is a very important piece of evidence showing the type of relationship the parties intended to create. A written agreement describing the worker as an independent contractor is evidence of the parties' intent. The substance of the relationship, not the label, governs the worker's status. The facts and circumstances under which a worker performs services are determinative. The substance of the relationship, not the label, governs the worker's status.

CWICs will occasionally encounter situations in which an employer is incorrectly treating a beneficiary as independent contractor when he/she actually meet the tests for being classified as an "employee" – meaning an employer-employee relationship exists as defined by US wage and hour laws. This misclassification is sometimes done out of ignorance of the DOL laws, but is occasionally willful in nature. Beneficiaries are sometimes treated as independent contractors to avoid paying minimum wage or avoid paying the employer taxes associated with having employees.

CWICs should advise beneficiaries when it appears that an employer is not properly applying DOL wage and hour laws. Beneficiaries who are being wrongfully treated as independent contractors may not be receiving a fair wage for work performed and may be losing valuable FICA and Medicare tax contributions. If the beneficiary wishes to pursue the matter, the CWIC should refer him/her to the nearest office of the US Department of Labor. If the DOL conducts an investigation and finds that the employer has violated the Fair Labor Standards Act, the employer could be required to pay the beneficiary back wages. In addition, if the IRS determines that an employer has incorrectly treated a worker as an independent contractor rather than an employee, it can assess the employer for all unpaid taxes, with respect to that worker and other workers performing similar services.

## **Statutory Employees**

A statutory employee is a special class of worker which actually meets all the tests for an independent contractor, but may be treated as an employee for Social Security withholding purposes (FICA and Medicare taxes). Some workers, who would be otherwise be considered independent contractors (i.e., self-employed) under the common-law rules for determining employer-employee relationships, are specifically defined as employees in section 210 of the

Social Security Act. There are only four categories of “statutory employees” as this is a very limited class of worker.

- A driver who distributes beverages (other than milk) or meat, vegetable, fruit, or bakery products; or who picks up and delivers laundry or dry cleaning, if the driver is an agent of the company or is paid on commission.
- A full-time life insurance sales agent whose principal business activity is selling life insurance or annuity contracts, or both, primarily for one life insurance company.
- An individual who works at home on materials or goods that a company supplies and that must be returned to the company (or its designee), if the company also furnishes specifications for the work to be done.
- A full-time traveling or city salesperson that works on a company’s behalf and turns in orders to the company from wholesalers, retailers, contractors, or operators of hotels, restaurants, or other similar establishments. The goods sold must be merchandise for resale or supplies for use in the buyer’s business operation. The work performed for the company must be the salesperson’s principal business activity.

Statutory employees are provided a W-2 from the company at the end of each tax year with the amount of Social Security wages in box 3. If an individual is considered a statutory employee, the company should check the “statutory employee” block on the W-2 to indicate his or her status. When filing tax returns, the statutory employee may be able to deduct trade or business expenses from the wages shown on the W-2 by filing a Schedule C or C-EZ. However, SSA uses the Social Security wages (reported on the W-2) as the gross income when assessing countable income for both SSI and DI beneficiaries.

### **Statutory Non-Employees**

There are only two categories of statutory non-employees: direct sellers and licensed real estate agents. They are treated as self-employed for all Federal tax purposes, including income and employment taxes, if:

- Substantially all payments for their services as direct sellers or real estate agents are directly related to sales or other output, rather than to the number of hours worked, and
- Their services are performed under a written contract providing that they will not be treated as employees for Federal tax purposes.

Beneficiaries who meet these tests are considered to be self-employed for both IRS and SSA purposes.

## **UNUSUAL SELF-EMPLOYMENT SITUATIONS**

Certain types of activities can be difficult to classify as self-employment, wage employment or hobbies. The situations CWICs encounter most include the following:

### **Ministers and Members of the Clergy**

Services performed by ministers or other members of the clergy are typically considered to be self-employment for Social Security coverage purposes, unless the minister has applied for and received an exemption from SECA (Self-Employment Contributions Act) taxes. However, ministers do receive an IRS Form W-2 (Wage and Tax Statement) from the church, order, or other entity for which they perform services. The Form W-2 should not show Social Security and Medicare wages or taxes since these would be paid by the beneficiary directly and not withheld by the church. Ministers can receive a variety of things in exchange for ministerial duties - some of which count as earned income while others will not. Gross income for a minister includes the following items:

- Salary;
- Fees and honoraria for officiating at weddings, christenings, funerals and other services in the exercise of the ministry;
- Rental allowance for a parsonage or value of a parsonage furnished to the minister;
- Value of meals when furnished as part of the compensation package; and
- Travel and automobile allowances, although these same items will be deducted as business expenses if incurred in the performance of ministerial duties.

A minister excludes the following things from gross income:

- Pensions and retirement pay;
- Parsonage or housing allowances when included in retirement pay after the minister retires, or any other retirement benefit received after retirement pursuant to a church plan as defined in Section 414(e) of the Internal Revenue Code, must be excluded when computing NESE. For example, if a minister retires from Church A and the rental value of a parsonage or any other allowance is included in his/her retirement pay the parsonage allowance must be excluded when determining NESE. However, if this same retired minister goes to work for Church B and is paid a parsonage allowance by Church B this new income must be included when computing NESE.
- Gifts, unless they are understood to be part of the minister's compensation.

CWICs are warned to be careful when counseling beneficiaries who say they are members of the clergy since there is so much variance in what this term actually means. In addition, even when a beneficiary does meet SSA's definition of a clergy member, there are some cases in which an ordained minister is clearly an employee of the church or religious organization. For example, this is often the case for individuals who serve as youth ministers or music ministers for churches or religious groups. There are even special rules for certain members of the clergy, such as individuals who have taken a vow of poverty or clergy who are in the US armed forces.

Whenever there is any doubt about the employment status of a minister or member of the clergy, refer the case to the local SSA office for a formal determination.

### **Directors of Non-Profit Organizations**

Beneficiaries sometimes want to start and manage a non-profit organization which they believe is a form of self-employment. In fact, an Executive Director or other paid manager of a non-profit corporation that has federal tax exemption status under 501(c) (3) of the IRS code is not considered self-employed. A non-profit organization is not “owned” by any person or entity in the way a business is owned, but rather is governed by a volunteer Board of Directors. The Executive Director of a non-profit organization is considered to be an employee of the organization who reports to the Board of Directors.

### **Artists and Authors**

SSA applies the same concepts described earlier when determining whether income derived from selling pieces of art or earning royalties from published written work constitutes self-employment income. Some endeavors begin as hobbies with no intention by the beneficiary of ever making a profit and as such, generally do not constitute engaging in trade or business. For example, if a beneficiary receives a royalty payment based on products that had been made originally as part of a hobby, the payments will not be considered as “earned” for the period the individual was doing the activity as a hobby. However, if the beneficiary continues to provide the same services or products with the intention of making a profit, any income derived might be considered as self-employment income. In other cases, a beneficiary is clearly in the business of producing and selling art or literature, in which case any net earnings from self-employment derived from the business would count as earned income for both IRS and SSA purposes. Again – the CWIC is not authorized to make determinations of this type. When any doubt exists the beneficiary must be referred to the local Filed Office for a formal determination.

### **Farmers**

Beneficiaries who derive income from farming are generally considered to be self-employed unless they are working as an employee of someone else who owns a farm. The rules governing how both the IRS and Social Security count farm income are terribly complex and depend on the unique circumstances of the individual. CWICs who encounter a self-employed farmer will need to contact their Technical Assistance Liaison with the WIPA NTC for help!

## **UNDERSTANDING NET EARNINGS FROM SELF-EMPLOYMENT (NESE)**

Before a CWIC can understand how self-employment income affects SSA disability benefits, there must be an understanding of how SSA views income generated from self-employment. For people who are self-employed, SSA does not count gross profits the business generated, but rather “net earnings from self-employment” or NESE. This is completely different from the way SSA treats earned income from wage employment in which gross wages are counted! There is a lot of confusion about the terms “gross” and “net” and what they mean for someone who is self-employed and receiving SSA disability benefits. Here is a brief explanation of the various terms:

- Gross income is the total amount of money that a business takes in from sales of products and/or services. This is also called “gross sales” or sometimes “gross receipts”.
- Net income is the amount of profit that the business makes. Profit is derived by taking the gross sales and subtracting any legitimate expenses that the business incurred. It is this figure that a business owner reports to the IRS in order for business taxes to be assessed.
- Net Earnings from Self-Employment (NESE) is the net income or net profit from a business less half of the self-employment taxes paid by the beneficiary.

### **Turning Net Income into NESE**

The difference between net income from a business and NESE is the deduction of the extra Social Security tax paid by self-employed people. For people in wage employment, employers pay half of the Social Security tax on an employee’s behalf, but self-employed individuals are required to pay the whole sum by themselves. When determining NESE, SSA gives self-employed individuals credit for paying the employer’s 7.65% share of the Social Security and Medicare taxes in addition to the 7.65% share they would normally pay as an employee.

When SSA is trying to determine NESE for a current calendar year, they will take the estimated profit the beneficiary expects and will multiply that estimated net profit of the business by .9235. That factor is determined by subtracting the percentage of extra taxes paid on each dollar of net earnings (.0765) from 1. When SSA is determining actual NESE for a calendar year which has concluded, Claims Representatives are instructed to perform the following steps:

1. Add the gross earnings from all trades or businesses carried on by the self-employed person.
2. Include the beneficiary’s distributive share of income from a partnership of which he /she is a general partner.
3. Exclude any types of income so specified by the Act or the Internal Revenue Code (IRC).
4. Subtract any ordinary and necessary expenses incurred in carrying on the business. In computing NESE, all of the business expenses which are deductible under the IRC must be subtracted from total receipts.
5. Multiply the result by .9235 (i.e., 100% - 7.65% = 92.35% or 0.9235) to derive the NESE, beginning with taxable years after 12/31/89.

**EXAMPLE:** Jeanne estimates that she will have \$2,000.00 in net profit. Jeanne operated her business beginning in November. The SSA would average the net profit in this estimate over the months worked: \$2,000.00 divided by 2 equals \$1,000.00 in net profit per month the business was active.

To determine Jeanne’s estimated NESE for those months, multiply \$1,000.00 by .9235.

$\$1000.00 * .9235 = \$923.50$  in NESE per month.



It is important to recognize that SSA only deducts the employer's share of the self-employment tax to determine NESE when the beneficiary actually paid that tax. If Social Security tax was not paid (either because none was owed or because taxes were not filed) the deduction does not apply. In addition, NESE may include in-kind income (e.g., food, clothing, shelter, a car, etc.). In-kind income from NESE is valued at its current market value.

Once SSA determines the NESE for a given month, they use that number as the starting point for SGA decisions and when determining how much in SSI will be due. Countable income would be determined by taking NESE and deducting any allowable work incentives. NESE is calculated in exactly the same manner for both SSI recipients and Title II disability beneficiaries. Keep in mind, however, that the countable NESE would affect SSI and Title II cash benefits in different ways – just as is the case in wage employment. Detailed explanations of how these programs treat NESE is provided later in this unit.

### **A Warning about “Owner’s Draw”!**

When someone takes money out of their business, it is called an “owner’s draw”. Owner’s draw is not a “salary” in the way this word usually is applied, but can include money, assets or services the owner takes out of the business. A common misconception is that SSA only counts what a beneficiary actually takes out of the business as earned income. Unfortunately, this is not true!

Remember that SSA is interested in the “net earnings from self-employment” or NESE which is essentially the net profit a business generates less half of the self-employment taxes. A business owner may choose to keep the profits of a business in the business account, or may take some or all of it out as an owner’s draw. The amount of owner’s draw a beneficiary takes is irrelevant to SSA. It is NESE that SSA uses when making SGA determinations for beneficiaries of the Title II disability programs and when determining how much in SSI is due.

In the SSI program, “owner’s draw” is referred to by SSA as “Withdrawals for Personal Use”. Since SSI is a means-tested program, taking in-kind items or cash out of the business for personal use could count as income to the individual which could cause a reduction in SSI cash payment, or possibly even cause ineligibility for SSI. When an individual alleges or when SSA discovers that cash or in-kind items are withdrawn from a business for personal use, SSA will ask the individual whether the withdrawals were properly accounted for in determining NESE. That is, were they either deducted on the individual’s Federal income tax return in determining the cost of goods sold or the cost of expenses incurred, or deducted on his business records? If the individual alleges that the funds were properly accounted for, SSA will accept this allegation and will NOT count this income against the individual again. If the withdrawals were NOT properly accounted for SSA will proceed in the following manner:

1. SSA will ask the individual to estimate the value of the cash or in-kind withdrawals. SSA will deduct that amount from the cost of goods sold or the cost of expenses incurred on the profit and loss statement to arrive at the proper NESE.

2. If the individual cannot or will not provide the profit and loss statement, but alleges an amount of NESE, SSA will add the value of the withdrawals to the individual's allegation of NESE.
3. If an individual alleges withdrawals for personal use but cannot or will not estimate the value of the withdrawals, or if the individual's personal expenses exceed the stated NESE and no other income is available, SSA will develop for unstated income.

CWICs should be aware that when an individual diverts money from a business to personal use without accounting for it through the business books, it is against IRS rules for both small business and individual income reporting. Beneficiaries should never be encouraged to do this under any circumstances! All income attributable to the business should be deposited into the business account (not a personal bank account) and must be reflected in the profit and loss statements for the business.

## **BUSINESS STRUCTURES MAY AFFECT HOW SSA COUNTS NESE**

There are numerous ways that small businesses may be structured and different business structures are treated in different ways when SSA is determining how much income to attribute to a beneficiary when conducting SGA determinations and determining how much in SSI is due. Business structure can also affect how the SSI program looks at the business assets when making resource determinations. The structure of a business matters and it is an important issue to counsel beneficiaries about. There are basically five types of business structures which are summarized below:

- **Sole Proprietorship** – The easiest way to form a business is as a sole proprietor and most small businesses have this structure. The business owner and the business are essentially the same. There is no need for legal documents and there are no filing requirements other than the IRS Schedule C in the individual tax returns. A sole proprietor does not even need a federal employer ID number, but can do business under the individual owner's Social Security number.
- **Partnership** – Partnerships are used when more than one person is involved in the ownership of the business. The partners share in income and expenses based on their percentage of ownership share in the partnership.
- **Limited Liability Company (LLC, PLLC)** – An LLC is the newest form of business ownership. It is a registered unincorporated entity. It gives the same legal protection as a corporation, but without as much of the reporting and taxing requirements. An LLC can be set up to function like a sole proprietorship, partnership or Sub S Corporation. Each state has certain requirements for setting up and maintaining an LLC.
- **Sub S Corporation** – A Sub S Corporation is treated like a partnership for tax purposes, but creates a separate legal entity. The ownership is in the form of shares, so ownership can be transferred more easily. A Sub S Corporation is usually formed with the aid of an attorney and/or accountant.
- **C Corporation** – A "C Corporation" is a standard corporation and most large businesses use this structure. C Corporations provide good liability protection for the

owner(s); however a C Corporation is seen as a separate entity and is taxed as such. This can result in double taxation. The corporation can pay taxes on income, then the owners pay taxes on distributions they receive. The ownership is in the form of shares. A C Corporation is usually formed with the aid of an attorney or accountant.

### **Special Rules for Officers and Directors of Corporations**

CWICs need to exercise caution when working with beneficiaries who are participating in businesses structured as corporations. Generally, SSA considers an officer of a corporation to be an employee of the corporation rather than a self-employed individual. A corporate officer is deemed to be in “employment” even if he/she performs no services for the corporation, as long as remuneration is received for holding corporate office. However, an officer of a corporation who as such does not perform any services, or performs only minor services, and who neither receives nor is entitled to receive, directly or indirectly, any remuneration for serving as an officer is not considered to be an employee of the corporation.

Although a corporate officer is generally an employee, payments made to the officer do not constitute “wages” unless such payments are made for performing services for the corporation or for holding corporate office. Payments by a corporation to an officer for reasons other than the holding of a corporate office are not wages. Examples of such payments would include payment of dividends, repayment of loans, or fees for services performed in other capacities of a non-employment nature. Corporations often make payments of this type to “honorary” or inactive corporate officers.

The board of directors is the governing body of the corporation and therefore is not subject to control by the corporation. Therefore, a director who attends and participates in board meetings would not meet the common law test for an employee, but would be deemed to be in self-employment. A director who does work for the corporation, other than attending and participating in the meetings of the board of directors, may be an employee with respect to such work if it is non-directorial in nature.

CWICs need to recognize that beneficiaries who are “officers” of relatively small companies that have been incorporated may think they are self-employed when, in fact, SSA considers them to be employees! It is a good practice to check with the local SSA Field Office whenever dealing with a beneficiary who is a corporate officer to verify employment status before offering advice. Remember that the difference between being an employee and being self-employed can have a significant impact on how benefits are affected – particularly in the SSI program.

For more information about this subject, refer to POMS RS 02101.016 - Officer or Director of a Corporation.

### **A Warning about Businesses Structured as Corporations**

Business structure does matter and in most cases, forming a corporation is NOT the best way to proceed for a variety of reasons! Accountants who are not accustomed to working with beneficiaries of SSA disability programs often recommend incorporation because it offers certain

tax advantages and because they want to make sure the business owner is protected from personal liability claims which result from accident or injury claims that occur in the business. If a beneficiary operates a business as a sole proprietorship or a simple partnership, for example, he/she can be sued personally by people with liability claims against the business – this means the beneficiary’s personal assets can be at risk!

There is another, more effective way of dealing with these liability issues in most cases – that is to file as a Limited Liability Company or LLC instead of a corporation. The LLC structure offers business owners the liability protection they need without some of the negative financial consequences of forming a corporation. The LLC structure is also very flexible. They can be designed to act like sole proprietorships, partnerships, or even corporations in some instances. Besides, filing an LLC is usually far cheaper and faster than forming a corporation!

**NOTE:** It is important to note that in the SSI program, LLCs are viewed as being the same as corporations so there is little advantage in using this business structure. In addition, certain resource exclusions (Property Essential for Self Support or PESS) the SSI program allows for eligible individuals who have business structured as sole proprietorships or simple partnerships are NOT afforded to business structured as LLCs. Detailed information about the impact of forming an LLC on SSI eligibility is provided further on in this unit.

A full explanation of the various structures a business can take and how each structure is treated by SSA would consume far too much space for this simple document. Suffice it to say that in the overwhelming majority of cases, forming a corporation will most often be detrimental to a SSA disability beneficiary – particularly SSI recipients. While corporations may offer certain tax advantages, the disadvantages of corporations in terms of the negative impact on benefit eligibility can far outweigh any benefit which incorporation might provide. It is critically important that beneficiaries meet with a certified CWIC who has experience in self-employment cases before they pay an accountant to incorporate a small business.

**NOTE:** Many self-employed beneficiaries use the services of a CPA, accountant or bookkeeper to keep their books and prepare their tax returns. It is important for these professionals to have some working knowledge of how self-employment affects beneficiaries of the SSA disability programs, but most will NOT have this knowledge or expertise. CWICs are encouraged to work closely with beneficiaries who are pursuing self-employment to help accounting and tax professionals understand the unique aspects of serving SSA disability beneficiaries.

## **SELF-EMPLOYMENT AND TITLE II DISABILITY BENEFITS**

Title II disability beneficiaries who are self-employed utilize the same work incentives as beneficiaries who are in wage employment with a few notable differences. This section will highlight the differences in the way NESE is treated as compared to gross wages.

### **The Trial Work Period and Self-Employment**

Work activity in self-employment constitutes “services” (i.e., a TWP month) when NESE in a calendar month is more than the current TWP guideline, or if the self-employed person spends more than 80 hours in that month engaged in self-employment activity. This can create some problems since many self-employed individuals don’t keep their business accounts on a calendar month basis, but rather just report profit to the IRS on an annual basis. When working with beneficiaries who are planning to become self-employed, CWICs need to stress how important it is to be able to track profits on a calendar month basis! If month-by-month profit and loss statements are unavailable and cannot be recreated, SSA has no choice but to determine if TWP months were used by dividing the NESE earnings for the particular work period by the months in which the beneficiary alleges he/she was engaged in self-employment. Averaging NESE in this manner out over a period of months may not always be in the best interests of the beneficiary and may cause more TWP months to be used than would be if a month-by-month break down were used. Again – CWICs need to advise beneficiaries to track business income and expenses on a monthly basis to insure that accurate TWP determinations are made!

Even if the NESE for a calendar month is less than the current TWP guideline, a service month may still have been used if the person spent more than a specified number of hours in that month performing the work activity she or he would normally undertake for the business’ profit. This means that under the current rules, it is possible for a beneficiary to have NESE under the current TWP guideline and still use a service month. This is NOT the case in wage employment and it represents a significant difference between how SSA looks at wages and NESE.

**Hours in a Business** A self-employed individual uses a TWP month if the Net Earnings from Self-Employment (NESE) is over the TWP amount, OR if the individual works more than 80 hours in the business. Either factor will cause SSA to count that month towards the nine months of the TWP. Beneficiaries should keep track of the hours worked in the business. Hours that count are hours spent on the ongoing business duties for pay or profit. The beneficiary should not count hours simply spent planning the business.

### **Special Work Incentives for Self-Employed Beneficiaries**

SSA recognizes that having business expenses paid for by someone else or getting free help operating the business, rather than using money from the business to buy the goods or services, artificially inflates the Net Earnings from Self-Employment (NESE). This means that the NESE may not accurately reflect the person’s actual earning capacity. When SSA makes SGA determinations, they are only concerned with the beneficiary’s OWN earnings ability – not help provided by others. SSA identifies two very separate and distinct work incentives which may be applicable in self-employment cases: “unincurred business expenses” and “unpaid help”.

### **Unincurred Business Expenses**

In determining countable income from self-employment, the SSA deducts from the individual’s NESE any business expenses which were incurred and paid by another person or agency. This

deduction is made even though no actual expense was incurred by the beneficiary. The item or service must meet the IRS definition of legitimate business expense, the value of which is determined by a variety of methods.

There are many kinds of un-incurred business expenses. For example, a local organization may pay for start-up equipment, or, more commonly, a state VR agency may purchase equipment or pay for initial operating costs. A family member or friend could give equipment or free rent to the beneficiary, et cetera. The SSA determines the value of these items and deducts the value from NESE when determining if someone is performing Substantial Gainful Activity.

### Unpaid Help

Another potential deduction occurs when someone gets free help operating the business. SSA can deduct the amount of wages the business would otherwise have paid the person if the business had to purchase the services instead of having them provided for free.

**EXAMPLE:** Lou is a lawyer who has just passed the bar. Her mother offers to help her in the office, and drive her van for her to help her get her business started. A neighbor offers to do some typing at no cost. Her parents give her 200 square feet of accessible office space at no cost, space that her parents could rent for approximately \$5 per square foot. Imagine Lou has 4,000.00 in NESE in the first month of her business. She has already used her TWP in a paralegal job while she was in law school. The SSA looks at her NESE to determine if she is performing SGA.

Lou's mother works 40 hours per week as an uncompensated assistant. In the market where Lou lives, that work would be worth at least \$10.00 per hour. The neighbor offers up to 10 hours a week in uncompensated work, which Lou accepts. Typists receive \$10.00 per hour in the community. Thus, Lou receives 50 hours per week at \$10.00 per hour, or approximately \$2,150.00 in uncompensated help. Subtracting this value from her monthly NESE leaves \$1,850.00.

The office space Lou uses is worth \$1,000.00 per month. The rent is an Unincurred Business Expense, and may also be deducted from her Net Earnings from Self-Employment.

Using the unpaid help and unincurred business expense deductions allows the SSA to adjust Lou's self-employment income from \$4,000.00 to countable income of \$850.00. In 2010, the SGA guideline is \$1,000 for individuals who are not blind. Because of subsidy for self-employed persons, Lou would NOT be considered to be performing SGA.

When examining unincurred business expenses or unpaid help, it is valuable to think through what the person needs, what the business has purchased, and what is given through family connections or services such as the state Vocational Rehabilitation agency (VR). It is essential to keep records of any items or equipment provided to a business for both tax purposes and for

SGA determination purposes since reconstructing these deductions from memory may be difficult.

### **How IRWEs are applied in Self-Employment Situations**

The rules for deducting IRWE are the same for self-employed individuals as for employees in wage employment. The big difference for beneficiaries who are self employed is that many expenses which would qualify as IRWEs also meet the IRS definition of allowable business expenses. When this is the case, it is much more advantageous for the beneficiary to deduct the expense when determining net profit since this decreases taxable income AND decreases the NESE for SSA purposes. By running the expense through the business accounts it also saves the beneficiary the time and effort of claiming an IRWE. It is important to note that individuals may not deduct the same expense as both an IRS deduction and as an Impairment Related Work Expense (IRWE) when SSA is determining countable NESE. The basic rule of thumb is that if the expense is an allowable deduction for IRS purposes, it should be deducted in this manner. If the expense in question does NOT meet the IRS definition of an allowable business expense, then the CWIC should explore the option of claiming the expense as an IRWE. When in doubt about whether or not an expense would qualify as a business deduction, CWICs are advised to refer the beneficiary to a qualified tax professional.

**EXAMPLE:** Lou purchased Dragon Naturally Speaking, a voice input software, for her computer. She was able to deduct this cost as a business expense. Although the cost meets all of the requirements for an IRWE, she may not deduct that cost as an IRWE, because it was already used to reduce her NESE.

CWICs should understand that there may be certain items which would meet the IRWE requirements but which might not qualify as an allowable business expense for IRS purposes. Beneficiaries should seek the services of a qualified tax professional whenever questions arise about what is and is not allowed as a business expense. To learn more about special tax rules for people with disabilities refer to IRS Publication 907 – Tax Highlights for Persons with Disabilities. This pamphlet can be found online at: <http://www.irs.gov/pub/irs-pdf/p907.pdf>.

### **SGA Determinations for Self-Employed Beneficiaries**

Determining if a self-employed individual is performing SGA is a little more complex than making the same determination for employees. First, SSA uses a slightly different form to collect information: the SSA 820 - Work Activity Report-Self-Employed. The information SSA seeks is also different because individuals who are self-employed have more control of the income reported to the IRS than employees usually have. Second, SSA uses two different approaches when making SGA determinations for self-employment beneficiaries – one approach for individuals who have been entitled to SSA disability benefits for 24 months or more and a different approach for individuals who have been entitled to benefits for less than 24 months. The following sections explain the differences between these two approaches.

### **Countable Income Test for SGA for Self-Employed Beneficiaries**

If a Social Security disability beneficiary is self-employed and has received cash benefits for at least 24-months, the Social Security Administration will use the countable income test to determine if the individual's disability has ceased due to SGA.

For the purposes of the exemption of work activity provision, a beneficiary will be considered to have received Title II disability cash benefits for 24 months beginning with the first day of the first month following the 24th month for which he/she received Title II disability benefits that he/she was due. The 24 months do not have to be consecutive. For EXR cases, the 24-month requirement will have been met when the individual completes the 24-month initial reinstatement period (IRP). Any months for which the beneficiary was entitled to Title II disability benefits but did not actually receive a Title II disability cash benefit will not be counted for the 24-month requirement.

When the countable income test applies, SSA will compare the self-employed beneficiary's countable income (NESE less allowable work incentives) to the earnings guidelines to determine if the beneficiary has engaged in SGA. If the monthly countable income averages more than the applicable SGA guideline for the month(s) in which the individual worked, SSA will determine that the individual has engaged in SGA unless there is evidence that shows the individual did not render significant services in the month(s). If the average monthly countable income is equal to or less than the applicable SGA guideline for the month(s) in which the individual worked, or if there is evidence that shows the individual did not render significant services in the month(s), SSA will generally determine that the individual has not engaged in SGA.

### SGA Test for Self-Employment When Countable Income Doesn't Apply

Under some circumstances SSA will not use the countable income test, but rather will apply a more complex three test approach to determine if an individual has engaged in SGA. SSA uses the three tests when:

- determining initial eligibility for disability benefits;
- determining whether work in self-employment performed by a Title II disability beneficiary before he/she has received Title II disability benefits for at least 24 months is SGA;
- determining whether work performed in or after the EPE/re-entitlement period is SGA after an SGA cessation has been determined; and
- determining SGA during the initial reinstatement period (IRP) for expedited reinstatement (EXR) cases.

The three tests are as follows:

1. **Test One:** Significant Services and Substantial Income - The individual's work activity is SGA if he or she renders services that are significant to the operation of the business, and if he or she receives from it a substantial income; or
2. **Test Two:** Comparability of Work Activity - The individual's work activity is SGA if, in terms of all relevant factors such as hours, skills, energy output, efficiency,



duties, and responsibilities, it is comparable to that of unimpaired individuals in the same community engaged in the same or similar businesses as their means of livelihood; or

3. **Test Three:** Worth of Work Activity -The individual's work activity is SGA if, although not comparable to that of unimpaired individuals, it is, nevertheless, clearly worth more than the applicable SGA Earnings Guideline when considered in terms of its effect on the business, or when compared to the salary an owner would pay to an employee for such duties in that business setting.

SSA applies these tests in the following manner:

**Test One:** Significant Services AND Substantial Income

The first test is called "Significant Services and Substantial Income". Significant services means that the beneficiary earned that money through his or her work effort. One-person businesses such as self-employed carpenters, gardeners, handymen, nurses, bookkeepers, consultants, and people in numerous other business operations may engage in their trade or profession by themselves, without employees, partners, or other assistants. The services of an individual in a one-person business are necessarily "significant." The receipt of substantial income by the operator of a one-person business will typically result in a finding of SGA.

In a business involving the services of more than one individual, a sole owner or partner will be found to be rendering significant services if he or she:

1. Contributes more than half the total time required for management of the business; or
2. Renders management services for more than 45 hours a month regardless of the total management time required by the business.

Where the services of a sole owner or partner are significant under either of the above tests, the individual will be found engaged in SGA if he/she receives a substantial income from the business. A self-employed individual will be determined to have a substantial income from a business if:

- a. "Countable income" (NESE less any applicable work incentives) from the business averages more than the appropriate SGA Earnings Guideline, or
- b. "Countable income" (NESE less applicable work incentives) from the business does not average more than the amount referred to above, but the livelihood which he/she derives from the business is:
  - Comparable to that which he or she had before becoming seriously impaired, or
  - Comparable to that of unimpaired self-employed individuals in his or her community engaged in the same or similar businesses as their means of livelihood.

If the self-employed person's average monthly "countable income" does not exceed the

applicable SGA guideline, SSA will consider whether the person's livelihood from the business is comparable to:

- that which he or she had before becoming seriously impaired, or
- that of unimpaired self-employed persons in the community engaged in the same or similar businesses as their means of livelihood.

The experience of the local Field Office is of particular value in determining whether the individual is deriving, or can be expected to derive, a substantial income from a business. SSA personnel should include in its determination an account of all the factors considered, so that it will be clear when an earnings report is not to be taken at face value. It is especially important that a detailed explanation be given as to the reasons why an apparently substantial business is reported as yielding a less-than-substantial income. On the other hand, a description of special conditions affecting an individual's business may make it clear why the beneficiary cannot derive the income ordinarily obtained from an enterprise of that type and scope.

- The type of business, amount of gross sales, the markup on products sold, and expenses such as rent, utilities, transportation, labor, costs, profit shares to employees and partners, etc., are among relevant items SSA should consider.
- When the business has been in existence for some time, data regarding operations in the past (e.g., income tax returns) should be obtained for the file.
- The impressions of the local SSA personnel, based on knowledge of local conditions obtained in the investigation of earnings credits claimed by self-employed individuals, will be particularly helpful in determining the validity of reported income and expenses.

A business from which the individual previously derived a substantial net income may now be expected to yield considerably less as a result of the curtailment of the individual's work due to the disability. Development should show whether the individual has been obliged to cut down the size of the business; operate the business fewer hours; hire additional labor to replace the individual's own labor; accept the unpaid help of family members or others or enter into a partnership arrangement so that the duties and income of the business will now be shared with others.

If the business was the individual's sole means of livelihood for a number of years before he/she became seriously impaired, and the individual continues to receive a comparable livelihood from it after becoming seriously impaired, SSA will generally consider his/her income to be substantial. However, in some cases, chronic illness or other special circumstances existing for some time prior to the individual's becoming (or allegedly becoming) disabled may indicate that his/her financial situation in that period cannot fairly be considered an indication of the individual's standard of livelihood. Under such circumstances, the community standard of livelihood would be a more pertinent basis for determining whether current and expected income from the business is substantial.

In some businesses, particularly farming, the operator derives a livelihood despite the fact that

cash income is small. Items which do not lend themselves to precise monetary evaluation such as homegrown food may be a considerable part of the individual's livelihood although not reportable for Federal income or Social Security tax purposes, and, therefore, not reflected on the earnings record. In the case of a farmer, although a monetary evaluation of such commodities is not controlling, the commodities should be considered in determining whether the yield from the farm is comparable to personal or community standards of livelihood.

Meeting the community standard of livelihood will be a sufficient basis for finding substantial income, regardless of the individual's economic circumstances prior to becoming (or allegedly becoming) disabled. However, in determining the community standard for similar business, SSA excludes from consideration individuals who are for various reasons considered unrepresentative (e.g., where chronic illness accounts for a low level of income).

The self-employed beneficiary should be questioned concerning the source and amount of his/her livelihood over a number of years (generally not less than 5 years) prior to becoming (or allegedly becoming) disabled. Where the individual's personal standard of livelihood is not met or the information furnished is inconclusive as to his or her personal standard of livelihood, SSA should obtain evidence regarding the community standard of livelihood for businesses of a similar nature. In some cases, the local Field Office's own observations and knowledge will be sufficient. In others, evidence will be needed from the local Chamber of Commerce or other informed sources.

### **Tests Two and Three: Comparability of Work and Worth of Work Tests**

If it is clearly established that the self-employed beneficiary is not engaging in SGA on the basis of significant services and substantial income under test one as described above, the second and third tests of the general evaluation criteria will be considered. Under these tests, the individual will be determined to be engaged in SGA if evidence demonstrates that:

1. The individual's work activity, in terms of all relevant factors such as hours, skills, energy output, efficiency, duties, and responsibilities is comparable to that of unimpaired individuals in the same community engaged in the same or similar businesses as their means of livelihood; or
2. The individual's work activity, although not comparable to that of unimpaired individuals as indicated above, is, nevertheless, clearly worth more than the applicable SGA guideline when considered in terms of its value to the business, or when compared to the salary an owner would pay to an employee for such duties in that business setting.
3. When the beneficiary operates a business at a level comparable to that of unimpaired individuals in the community who make their livelihood from the same or similar kind of business, SSA may determine that the beneficiary is engaging in SGA. To establish comparability of work activity, SSA must show that the beneficiary is performing at a level comparable to that of unimpaired persons considering the following factors: hours, skills, energy output, efficiency, duties and responsibilities. The lack of conclusive evidence as to the comparability of the required factors will result in a finding that the work performed is not SGA under the comparability test.

An important part of the comparison is the selection of the group of unimpaired persons and the type of self-employment must be the same. In addition, the unimpaired persons must maintain on the basis of their activity a standard of living regarded as adequate for a particular community. Well-established businesses are generally the most reasonable choice for comparison.

Development of comparability of work must be specific. Each factor cited above must be described in detail, showing its contribution to the business operation. General descriptions are considered inconclusive evidence for the point-by-point comparison the evaluator is required to make. SSA instructions clearly state that if only a general description is possible or available, any doubt as to the comparability of the factors should be resolved in favor of the beneficiary.

Evidence of the beneficiary's activities accompanied by a statement that the work is comparable to the work of unimpaired persons is insufficient for a sound SGA decision. If necessary, a description should be obtained through a personal interview with an unimpaired self-employed individual from the selected group. It may be necessary to have a more comprehensive description of the impaired individual's activity than that which can be provided by the impaired person. SSA personnel are instructed to make contact with people having first-hand knowledge of the beneficiary's work situation obtained through actual participation or observation.

The degree to which evidence of comparability or worth of services should contain data supplied by outside authorities will depend on the individual situation. In many instances, the familiarity of the local Field Office with local conditions will make it unnecessary to document the file in great detail. For example, it may be evident in a poor farming area that management services on a small farm yielding a less-than-subsistence income would not be comparable to the full range of physical and mental activities performed by an able-bodied farm operator, nor would the services be clearly worth more than the applicable SGA guideline. On the other hand, where there is any doubt as to the comparability or worth of services, SSA should obtain evidence in appropriate detail and supplement it as required by opinions from authoritative sources in the community.

**EXAMPLES:** Test 1 -- Myrtle has a small accounting business. Her average NESE is \$2,000.00 per month for the period she worked this year. She has deductions for IRWE, and unpaid help of \$400.00. Myrtle is a sole proprietor, and thus her work is significant to the business. Myrtle has substantial income, and is thus performing SGA.

Test 2 -- Fred is a plumber. He has NESE of \$500.00 a month. Fred does plumbing full-time, however, and plumbers in his area make \$5,000.00 per month. Fred does the plumbing himself and does as much work as other plumbers who work in his community. The SSA determines that Fred's work is comparable to SGA-level work. The SSA decides that Fred is performing SGA.

Test 3 -- Octavia does typing and photocopying for small businesses in her community. Because of her disability, Octavia takes fewer jobs than other

services. Even so, considering the effort and time that Octavia spends, and the number of jobs she completes, her work should be worth \$1,100.00 a month, instead of the \$200.00 per month she reports. Octavia is not blind, and the applicable SGA guideline is \$980.00. The SSA decides Octavia is performing SGA.

**NOTE:** The comparability of work, and worth of work tests never apply to beneficiaries who meet the definition of statutory blindness. For blind individuals, only the Significant Services and Substantial Income tests are relevant.

### **Use of Averaging in Self-Employment Cases**

Since self-employment income may fluctuate widely due to transitory business conditions, changes in the nature and size of the business, improved methods of operations, or other factors, the self-employed beneficiary is far less likely than an employee to have a uniform monthly income which can be readily compared to the SGA guidelines. Because of this variance, SSA averages the individual's countable income by figuring total countable income over a representative period and dividing by the number of months in that period. As in the case of employees, income is generally averaged over the entire period of work requiring evaluation which may be up to a full calendar year. For some beneficiaries that period could be an entire calendar year, while for others it could consist of a just a few months. SSA will average separately the distinct periods of work involved when there is a regulatory change in the SGA earnings level or there is a significant change in work patterns or income.

### **SGA Determinations When Multiple Work Efforts Exist**

Sometimes beneficiaries are engaged in self-employment and also hold wage employment jobs at the same time. Still other beneficiaries may operate more than one small business simultaneously. When more than one work effort exists at the same time, each is considered separately during an SGA determination. If any one endeavor is found to represent SGA, the case is decided on that basis. If no single work effort equals SGA, then the income from all work efforts is combined. Total earnings would never be reduced by any self-employment loss. The self employment income would simply be represented as zero.

### **Final Words about Self-Employment and SGA Determinations**

It is much more likely that SSA will make accurate and correct SGA determinations for self-employed beneficiaries if they keep complete accounting records. There are benefit implications related to the manner in which financial records are kept as well as the accuracy of month-by-month accounts. Since SGA determinations in self-employment situations can be so complex, beneficiaries are advised to seek assistance from qualified accountants or bookkeepers in maintaining their financial records.

## **SSI AND NET EARNINGS FROM SELF-EMPLOYMENT (NESE)**

The SSI program treats income from self-employment very differently from wages in some important ways. First, the POMS instructs SSA personnel to estimate NESE for the current taxable year during an initial claim, redetermination, or review of income when an individual alleges he/she is (or has been) engaged in self-employment during the current taxable year. Claims Representatives are instructed to advise the individual:

- how his/her estimated NESE was determined and its effect on eligibility and/or payment amount,
- to promptly contact the field office if any change occurs which could affect the amount of his or her estimated NESE,
- to maintain business records until a Federal income tax return is available, so he/she can report any changes promptly, and
- to provide a copy of his or her Federal income tax return when it becomes available.

If the beneficiary is engaged in a new business, the estimate is generally based on the individual's allegation about what profits he/she expects to generate by the end of the calendar year.

Depending on how much (or how little) the expected profit will be, SSA will compute NESE by subtracting the employer's share of the self-employment tax by using the multiplier of .9235. If the beneficiary has engaged in a new business for a partial year SSA will obtain the individual's profit and loss statement or other business records for his or her taxable year to date, will ascertain his/her net profit to date, and will project that net profit for the entire taxable year to adjust the SSI cash payment moving forward. SSA personnel will NOT use this method of estimating NESE for businesses which are seasonal or have unusual income peaks at certain times of the year. This is done to avoid underpayments caused by overestimating NESE and reducing the SSI cash payment too much. After the initial year of business operations, SSA will take the actual annual NESE from the initial year of operations and divide it equally among the number of months in the taxable year - which would be 12. They divide it over 12 months even if the business:

- is seasonal;
- starts during the year;
- ceases operation before the end of the taxable year; or
- ceases operation prior to initial application for SSI.

A period of less than 12 months may be a taxable year if:

- the basis for computing and reporting income changes (e.g., fiscal to calendar year); or
- the taxpayer dies (the taxable year ends on the date of death, and net earnings are computed as of the date of death); or
- the taxable year is closed by the Commissioner of IRS.

**NOTE:** An individual's taxable year is NOT ended when the beneficiary goes out of business. Once SSA has determined how much NESE to attribute to each month in the calendar year, they retroactively apply this income to determine how much in SSI cash payments were due. The SSI check will be adjusted retroactively for the entire

calendar year. In most cases if the business generated more profit than was expected, it will mean that the SSI recipient will have been overpaid. After that first year of self-employment, SSA will generally use the NESE from the prior year as an estimate of monthly countable income for the current taxable year, unless the beneficiary alleges his/her NESE for the current year will vary from NESE for past years and gives a satisfactory explanation for the variation.

**EXAMPLE:** Martika is self-employed in a sole proprietorship. Martika started her business in December, and made \$1,200.00 in NESE after all business deductions, including deductions for the extra Social Security taxes she pays as a self-employed individual. Although Martika didn't start her business until December of 2006, SSA will consider Martika's earnings to be \$100.00 per month throughout the 2006 calendar year.

**EXAMPLE:** Torrey operates a small business doing interior design. He began his business in March and he made a profit of \$2,600 during the first 6 months of the year. Unfortunately he accepted a big job in the second half of the year that lost money. When he filed his taxes for the year it turned out that his NESE represented a loss of \$200. Torrey submitted his tax returns to SSA and his SSI check was NOT reduced for the past 12 months since he incurred a business loss. In the coming year, however, Torrey estimates his profit to be \$3,000. For the coming 12 months, SSA will count an average of \$250 in countable NESE which would make his adjusted SSA payment \$591. Torrey plans to watch his profits on a month-by-month basis and adjust his estimate of projected NESE if actual profits are significant higher or lower than his projection.

If the business lost money in the calendar year as verified by the tax returns, SSA divides any verified net loss for a taxable year evenly over the months in the taxable year. SSA will subtract each monthly net loss amount from the individual's other earned income (NESE or wages) in the same month, if any exists. SSA does not take into account an estimated net loss when estimating NESE for the current taxable year since a net loss can only be used to offset other earnings after it has been verified. Only verified losses can be used to offset other forms of earned income.

### **Application of SSI Work Incentives for Individuals who are Self-Employed**

There really are very few differences in the way the SSI work incentives are applied in wage employment and self-employment cases. The Student Earned Income Exclusion (SEIE) and Blind Work Expenses (BWE) are applied in the exact same fashion regardless of whether the beneficiary is wage employed or self-employed. CWICs simply apply the deduction in the SSI calculation chart in the appropriate place to arrive at countable NESE.

As previously explained, the rules for deducting IRWE are the same for self-employed SSI recipients as for employees. The big difference for beneficiaries who are self-employed is that many expenses which would qualify as IRWEs also meet the IRS definition of allowable business expenses. When this is the case, it is much more advantageous for the beneficiary to deduct the expense when determining net profit since this decreases taxable income AND

decreases the NESE for SSA purposes. By running the expense through the business accounts it also saves the beneficiary the time and effort of claiming an IRWE. It is important to note that individuals may not deduct the same expense as both an IRS deduction and as an Impairment Related Work Expense (IRWE). The basic rule of thumb is that if the expense is an allowable deduction for IRS purposes, it should be deducted in this manner. If the expense in question does NOT meet the IRS definition of an allowable business expense, then the CWIC should explore the option of claiming the expense as an IRWE.

### **Self-Employment and Medicaid**

SSI applies the 1619(b) extended Medicaid provisions in exactly the same manner for self-employed individuals as for persons who are in wage employment. Once NESE exceeds the break-even point the SSI recipient will stop receiving a cash payment and eligibility for continued Medicaid under 1619(b) will be assessed. The same eligibility criteria apply as in wage employment:

- Annual countable NESE must remain below the State threshold (work incentives apply to reduce countable income during 1619(b) determinations), unless an individualized threshold amount can be applied.
- The individual must still be disabled per SSA's definition.
- The individual must meet all other SSI eligibility requirements other than earnings (unearned income and resource limits).

CWICs must be aware that State Medicaid agencies are not accustomed to dealing with beneficiaries who are self-employed and often misapply the rules governing how NESE is determined and applied during Medicaid eligibility determinations. It may be necessary to print the POMS citations describing how NESE is determined in the SSI program to facilitate proper Medicaid determinations.

### **Important Considerations for SSI Recipients who are Self-Employed**

During the initial tax year when a beneficiary first begins self-employment, it may be impossible to determine what NESE will be in order to report it to SSA. This makes CWICs uncomfortable because they are accustomed to advising beneficiaries to report earned income in advance or at least shortly after employment begins. While it is required that an SSI recipient inform SSA when he/she is embarking on small business ownership in the initial months of self-employment, there really is not much one can do by way of reporting income. In self-employment, an individual may have profits one month and incur losses the next month. In some cases, there may be no way of knowing whether there will be countable NESE until the entire tax year has ended and the results are reported on tax returns.

The best course of action is to inform SSA that a small business has been started as soon as operations begin. SSI recipients should initially provide a very conservative estimate of expected profits to SSA. If no profits are expected, it is imperative that this be reported to SSA to avoid unnecessary reduction of SSI cash payments. CWICs should advise SSI recipients to



watch their profit and loss statements on a month-by-month basis to see if profit is generated. If a profit is generated which is not offset by losses in previous months, the SSI recipient should report it to SSA so that SSI cash payments can be adjusted accordingly. CWICs must clearly explain how this estimation process works to SSI recipients who engage in self-employment and should help these individuals minimize the risk of overpayments if the business profit exceeds initial projections.

After the initial tax year of self-employment, SSA uses projected estimates of annual NESE at the start of each calendar year to calculate the monthly SSI payment for the coming 12 months. This projection is based on the NESE earned for the prior year using completed tax returns and may be adjusted based on what the beneficiary expects profits to be for the coming year. Providing SSA with inaccurate projections can have serious implications for SSI recipients. If the annual NESE projection is too high, the SSI monthly payment will be unnecessarily low and underpayment of benefits will result. If the annual NESE projection is too low, the monthly SSI check will be too high and overpayment will result.

The solution to this problem is to work closely with SSI recipients when developing projections of NESE and to track the actual profits the business generates on a month-by-month basis. By the mid-point of the year, if the profits appear to be off, CWICs should help the beneficiary develop a revised NESE projection which should be reported to SSA. The beneficiary should continue to monitor profits for the remainder of the year and then submit completed tax returns as quickly after the tax year ends as possible. The objective is to avoid any substantial over or underpayment of SSI benefits.

### **Small Business Ownership and Resource Determinations for SSI Recipients**

In many instances, owning a business with assets, property, equipment and/or cash in business accounts will not cause ineligibility for SSI or Medicaid, but it all depends on how the business is structured. Remember that individual SSI recipients may not have more than \$2,000 in countable resources to stay eligible for benefits, while eligible couples have a combined resource limit of \$3,000. However, for businesses structured as sole proprietorships or simple partnerships, assets held by the business are specifically excluded as countable resources under a special provision called “Property Essential for Self-Support” or PESS.

The PESS provision allows SSI recipients to have certain property excluded during resource determinations, regardless of its value or rate of return. PESS exclusions apply to:

- property used in a trade or business (effective 5/1/90);
- property that represents government authority to engage in an income producing activity;
- property used by an individual as an employee for work (effective 5/ 1/90); and
- property required by an employer for work (before 5/1/90).

The POMS citations describing application of PESS begin at the following URL:  
<https://secure.ssa.gov/apps10/poms.nsf/517e83681a5eb8b28525688d0058721c/97b2eda9325340a78525754c00073830!OpenDocument>.

## **PESS for Businesses Structured as Corporations or Limited Liability Companies**

CWICs must understand that the PESS exclusions do NOT apply when the SSI recipient has a business which is incorporated. In these situations, it is as if the SSI recipient owns “stock” in the business as a shareholder and the value of this “stock” is counted as a resource for SSI eligibility purposes.

In addition, SSA recently changed the rules for how PESS applies to businesses structured as Limited Liability Companies or LLCs. Basically, the new ruling says that a business using the LLC structure is essentially the same as a corporation, so PESS does not apply. Under this new ruling, only businesses structured as simple partnerships or sole proprietorships would be permitted to exclude business assets under the PESS provisions. The problem with that is that these business structures offer beneficiaries no protection from assuming personal liability if the business is sued. This is a major reason why small businesses are formed as LLCs – it allows the business to assume liability and protects business owners from having lawsuits attack their personal assets. This creates a problem for SSI recipients who want to own small businesses. With this new ruling, they may have to choose between liability protection and PESS protection. In some cases, it will be possible for individuals to purchase professional or business liability insurance sufficient to protect personal assets, but this would be an additional expense.

## **SELF-EMPLOYMENT AND PASS**

Many beneficiaries who are pursuing a self-employment goal can be assisted in achieving this goal by developing a Plan for Achieving Self-Support or PASS. Since establishing a small business may require start-up funding, developing a PASS can be a valuable method for generating this start-up capital. CWICs should always check to see if PASS is a possibility for any beneficiary who indicates an interest in becoming self-employed.

### **Business Plans and PASS**

A PASS with a self-employment goal must include a detailed business plan which follows a very specific format. A copy of the business plan outline which SSA requires is provided at the end of this unit. These requirements can also be found in the POMS online at:  
<https://secure.ssa.gov/apps10/poms.nsf/lnx/0500870026>

SSA will not deny a PASS because the business plan does not cover required elements. If the individual is willing to work on the business plan, PASS Specialists will provide assistance or direction as needed. For example, in some cases, this may involve asking a few questions which the individual may know or quickly determine. If appropriate, PASS Specialists will refer the individual to a third party who can help the person develop a detailed business plan. Such sources include the U.S. Small Business Administration and its sponsored organizations, the Service Corps of Retired Executives (SCORE) and Small Business Development Centers (SBDCs), State VR agencies, local chambers of commerce, local banks, and appropriate staff at

local colleges and universities. Costs associated with developing a business plan (if any) may be included in the PASS as an allowable expense.

### **Start-up Costs**

Start-up costs refer to the expenses associated with opening a business. PASS expenses are limited to the start-up costs for the particular work goal. For someone opening a business, the start-up costs include the expenses to start the business through the first 18 months, or longer if needed, of the business' operation. The use of an item as a business expense in determining net earnings from self-employment does not preclude its use as a PASS expense during the calendar years (or fiscal years) that encompass the start-up period of a business.

A business will be given a minimum start-up period of 18 months unless the individual indicates that less time will be needed for the business to sustain its operations. A request for a start-up period of a longer duration than 18 months must be justified.

### **PASS and Businesses Structured as LLCs**

While membership or distributional interests in an LLC cannot be excluded as property essential to self-support (PESS), they may be excluded for a PASS if the consequences of not excluding them would prevent the individual from being able to achieve the goal.

**EXAMPLE:** Jane is opening a catering business. She needs liability protection in the event that someone becomes ill or dies after consuming her products, or is dissatisfied with her services and files suit. Without such protection, the business assets and her personal assets could be wiped out, leading to financial instability and closure of the business.

To obtain adequate liability protection, Jane must: (1) establish a business structure that prevents her personal assets from being depleted, and (2) purchase liability insurance to protect the assets used in the business from being depleted in the event of a lawsuit.

The LLC business structure prevents Jane's personal assets from being subject to lawsuits related to negligence or perceived negligence by the business. Liability insurance then provides for a certain level of compensation for damages if an error occurs.

Without the protection against personal liability that an LLC provides, Jane would have to purchase a larger amount of liability insurance. The increased cost of that insurance would reduce her profits so dramatically that it would not be financially feasible for her business to succeed.

Consequently, the LLC business structure and her membership interests in the LLC are essential to Jane's ability to operate her catering service.

CWICs do not need to develop and document the details when someone alleges that liability

protection makes an LLC the best business structure for them. As mentioned earlier, however, it is important to be sure they understand that the value of their membership interests will count as a resource when the PASS ends and that, if that causes their resources to exceed the SSI limit, they will not be eligible for Medicaid while working under section 1619(b).

In summary – it may be possible to use the LLC structure during the period in which a PASS is in effect since the business assets could be protected by the PASS exclusion provisions. However, when the PASS ends, SSA would count the value of the individual’s membership share in the LLC as a resource, which could result in ineligibility for SSI and Medicaid.

## **SELF-EMPLOYMENT COMBINED WITH WAGE EMPLOYMENT**

Some beneficiaries participate in both wage employment and self-employment simultaneously. SSA has very specific rules about how income is counted in these cases.

For Title II beneficiaries, SSA determines countable income for the wage employment and the countable income for the self-employment separately and adds the two forms of income together when making SGA determinations. Losses from self-employment cannot be used to offset SGA level earnings in wage employment. (See DI 10505.015 Averaging Countable Earnings)

In the SSI program, any verified net losses from self-employment are divided over the taxable year in the same way as net earnings. The average monthly net loss is deducted only from other earned income of the individual or spouse in that month to determine gross income. Work incentives would then be deducted from that amount when determining how much the SSA payment should be. (See SI 00820.210 How to Determine Net Earnings from Self-Employment)

## **SELF-EMPLOYMENT AND THE CWIC**

Self-employment cases can be challenging for CWICs because they combine the complex effects of self-employment earnings and small business ownership on public benefits with the intricacies of private sector business planning and management. This combination sometimes causes CWICs to become confused about their role in working with beneficiaries who are considering self-employment, or who already operate small businesses. The charts on the following pages are designed to clarify CWIC roles and responsibilities, as well as the limitations within each of the two critical areas specific to self-employment: the business domain and the benefits domain. Before we delineate these roles, let’s take a closer look at how to initiate WIPA services with beneficiaries who plan to pursue self-employment.

### **Counseling Beneficiaries with Self- Employment Goals -- Starting the Process**

When a beneficiary expresses interest in self-employment, or is already engaged in some form of self-employment, the first step a CWIC must take is to determine where the beneficiary in the process of establishing a small business:

- Initial stages of considering self-employment
- Business concept development stage
- Business planning stage
- Business start-up stage
- Business operations stage

Where the beneficiary is in the self-employment process determines what services the CWIC provides and defines the timeline for service delivery. It is much easier to advise beneficiaries who are in the very early stages of planning a business – before missteps may have been taken which will require correction. The CWIC’s role at this initial stage will involve:

- Helping the beneficiary decide if self-employment is the best option
- Working with the beneficiary to determine if the activity he/she plans to pursue would be considered self-employment, wage employment or a hobby
- Advising the beneficiary on sources of support in refining a business concept or testing the concept for feasibility
- Referring the beneficiary to sources of assistance for developing a written business plan
- Offering general advice on how self-employment income will affect disability benefits and how work incentives may be used to finance business start-up

Some individuals who want to become self-employed lack an understanding of what this goal truly entails. Before the CWIC spends a great deal of time and energy connecting the beneficiary with sources of assistance with feasibility analysis and business plan development, it is wise to explore how well the beneficiary has thought through the implications of pursuing self-employment. At the end of this unit, there is a handout that is recommended for use in any initial discussion about self-employment. This handout (titled “So, You Want to be Self-Employed”) lists the major areas around which planning will need to occur and will help the CWIC structure a review of what needs to be accomplished. This handout will help the CWIC probe how well the beneficiary has really thought out the process of becoming self-employed and will highlight the areas in need of work. The following items should be covered in this conversation:

1. Business feasibility
2. Capitalizing business start-up
3. Developing a written business plan
4. Business structure
5. Accounting and financial record keeping
6. Tax implications of self-employment
7. Licenses, permits or other legal requirements
8. Accommodations needed to operate the business successfully
9. How self-employment will affect SSA disability benefits and other public benefits

Once the beneficiary has explored all of the areas listed above, the next step will be to begin business feasibility assessment and business plan development. This is where the CWIC begins to enter unfamiliar territory as these are clearly business functions which most CWICs have very little experience with. The following chart provides some direction on activities within the

business domain which CWICs should participate in as well as boundaries or limits CWICs have in this domain.

**The Business Domain**

<b>CWICs should:</b>	<b>CWICs should NOT:</b>
<ol style="list-style-type: none"> <li>1. Research local resources that are available to help beneficiaries with business planning, feasibility studies, financing, accounting systems and bookkeeping, tax planning/preparation, and setting up corporations/LLC, etc.</li> <li>2. Provide specific information and referral services to help beneficiaries connect with local sources of business expertise and assistance.</li> </ol>	<ol style="list-style-type: none"> <li>1. Help beneficiaries decide what type of business they should pursue.</li> <li>2. Determine whether or not a beneficiary is capable of starting and managing a business.</li> <li>3. Provide direct assistance with writing, editing or critiquing business plans.</li> <li>4. Share information with beneficiaries on any legal or tax issues related to business establishment or management.</li> </ol>
<b>CWICs should:</b>	<b>CWICs should NOT:</b>
<ol style="list-style-type: none"> <li>3. Help beneficiaries understand the business plan requirements inherent in the PASS program – reviewing business plans and providing general feedback about whether PASS requirements are met or not.</li> <li>4. Advise beneficiaries about the impact of various business structures (corporations, LLC, sole proprietorship, etc.) on public benefits.</li> <li>5. Advise beneficiaries on the impact of accounting methods (accrual vs. cash) on public benefits.</li> <li>6. Help beneficiaries understand how to include work incentive payments in business financial statements</li> </ol>	<ol style="list-style-type: none"> <li>5. Give advice to beneficiaries on sources of business financing beyond work incentives related to public benefits. CWICs do not assist with preparing financing requests or loan applications.</li> <li>6. Perform feasibility studies or assessments. CWICs are not qualified to evaluate the viability of a business concept.</li> <li>7. Prepare financial statements for the business such as break-even analysis, cash flow analysis, or income/expense statements.</li> <li>8. Provide business analysis, consultation and problem solving services to increase profitability.</li> </ol>

Let's take a closer look at the CWIC role in some of the most common areas related to the business domain:

### **The Business Concept and Business Feasibility**

It is not uncommon for a beneficiary to pitch a business concept that may seem a bit unrealistic to the CWIC. In many cases, the beneficiary will be very excited about the idea and utterly convinced that it will result in a highly profitable business. CWICs may feel tempted to get into a debate with the individual about the feasibility of the business concept, but the CWIC role in this area is very limited. When discussing business feasibility with beneficiaries, CWICs are cautioned to keep the following boundaries in mind:

- It is NOT the CWIC's job to tell a beneficiary that a business concept is unrealistic, unfeasible, not-workable, etc.
- It IS the CWIC's job to know when a business concept may need more refinement or study before a business plan can be written or before successful start-up is likely.
- It IS the CWIC's job to know where a beneficiary can go for help with developing a solid business concept and to make referrals to these entities.
- No matter what the CWIC may think of the business concept, he/she is responsible for providing specific information about how self-employment income as projected by the beneficiary and business support team will affect benefits and how work incentives may apply.

### **The Business Structure Decision**

First and foremost, it is important for CWICs to explain to beneficiaries preparing for self-employment that business structure does have an impact on how the NESE will be treated and also may affect resource determinations for SSI recipients. If the beneficiary has not yet determined what business structure is best the CWIC should provide advisement on how SSA treats different types of structures and how the various structures may affect that individual's benefits. This is particularly true of SSI recipients since certain business structures (corporations and LLCs) do not allow business assets to be disregarded by PESS provisions during resource determinations. In these cases, using the wrong business structure could cause the individual to lose SSI and Medicaid prematurely.

CWICs need to realize that many accountants will recommend that businesses be incorporated since this is often most advantageous for individuals who are not on disability benefits. CWICs need to warn beneficiaries about this possibility and should be specific about why this course of action would not be most advantageous. The CWIC should provide written material on this subject to the beneficiary for sharing with the accountant and should offer to answer questions the accountant might have about how SSA benefits are affected by business structure. CWICs should be familiar with knowledgeable sources for assistance in making business structure decisions (SBA, SCORE, etc.) and should make direct referrals to these sources when necessary.

If the business structure has already been established by the time the beneficiary makes contact with the CWIC, it will be necessary to discuss how SSA will treat income from the business

based on chosen business structure, and identify potential options for changing business structure, if such a step is warranted. Business structures can be changed once a business is operational, although it may cause some inconvenience and incur expense to the business owner.

### **Business Plan Development**

The very first thing to do is to determine whether or not a formal written business plan is actually necessary. In most cases, it will be, but in some cases, it will not. If the business is a sole proprietorship with no need for capitalization, there may be no need to develop a detailed plan. In most cases, a business plan is necessary under the following circumstances:

- If a PASS will be pursued
- If the State VR Agency or EN is providing funding for the business
- If a business loan is being sought
- If other funding sources requires it

If a business plan does need to be developed, the CWIC needs to be familiar with the agencies or individuals in the local area that provide assistance and support in this area. CWICs are responsible for referring beneficiaries to local resources to assist with business planning process. They should also review general information about how SSA treats self employment earnings.

### **What CWICs Need to Know About Business Financials**

It is NOT the CWIC's job to develop financial projections, determine profit estimates or make cash flow projections. However, CWICs are expected to assist with advising the beneficiary and their supports (family, accountant, business planning team) on the impact of financial projections or business profits on benefits. When working with small businesses, CWICs are primarily interested in the bottom line – the net profit of the business. The net profit figure is the starting point for specific advisement on NESE and use of applicable work incentives. In most cases, the CWIC will need to know how to read a simple Profit & Loss Statement (P&L). This is a common financial report used to project business profit (or loss) which is generally prepared in a spreadsheet format. Typically, the Business Income (sales, returns, etc.) listed across top with individual business expenses listed by category underneath. The expenses are subtracted from the income to calculate net profit or loss. There are some specific things CWICs need to know about Profit & Loss Statements and how work incentives should be accounted for such as:

- PASS expenses that are also IRS allowable business expenses should be included in P&L statements. PASS expenses which would NOT meet IRS rules for business expenses should not be included in the P&L. PASS income should NOT be listed in the P&L as it is not a form of income, but rather is considered to be “owner's investment”. For tax purposes, the income which beneficiaries use to fund a PASS would be considered income attributable to the individual rather than the business. Any tax liability would be the responsibility of the individual beneficiary as indicated by the individual's tax returns.



- IRWEs/BWEs that are also IRS allowable business expenses should be included in the P&L statements. CWICs should note that IRWEs/BWEs included as business expenses cannot also be claimed as when reducing countable NESE during SGA determinations or when the SSI check is being adjusted. That is because the expenses have already been accounted for when determining the amount of profit. To claim these expenses a second time would constitute “double dipping” and is not permitted.
- Beneficiaries should NOT include any expense item that is purchased directly by another source (VR, WIA, etc.) in the P&L statements. However, if funds from other sources (VR, WIA, etc.) are given directly to the business owner, both the funds and the expenses are included in the P&L.

**NOTE:** Items or cash received to pay for rehabilitation needs that a beneficiary has may be excluded from income reported to the IRS under certain circumstances. In IRS Publication 525, there is an exemption on Page 27 under the section on “Welfare and Other Public Assistance Benefits” that reads:

*“If you have a disability, you must include in income compensation you receive for services you perform unless the compensation is otherwise excluded. However, you do NOT include in income the value of goods, services and cash you receive, not in return for your services, but for training and rehabilitation because of your disability. Excludable amounts include payments for transportation and attendant care, such as interpreter services for the deaf, reader services for the blind, and services to help mentally retarded persons do their work.”*

### **CWIC Role in Accounting and Financial Record Keeping**

CWICs have a very limited role in accounting or other financial record keeping matters. Keep the following parameters in mind when counseling self-employed beneficiaries:

- CWICs are not accountants – do NOT advise beneficiaries on specific accounting techniques or strategies.
- CWICs may be called upon to advise accountants and/or bookkeepers about various things including:
  - Record keeping for SSA
  - Impact of self-employment income on benefits
  - Impact of accounting on work incentives usage or vice versa
  - Business structures - Many accountants recommend incorporation for tax reasons which may be disadvantageous to the beneficiary
- Some accountants do have knowledge of SSA benefits. When that is the case the CWIC should be ready to provide resource/referral information as necessary.
- CWICs should inform self-employed beneficiaries of all information that should be gathered and retained. Most of the information SSA needs is the same information

the IRS requires. SSA (other benefits programs) may require additional information.

**The Benefits Domain**

This is the area where CWICs have a great many responsibilities. CWICs are expected to have a solid understanding of how self-employment income affects SSA cash benefits, Medicaid/Medicare as well as other Federal, State and local benefits. There is no different between wage employment and self-employment in terms of the CWIC’s benefits counseling and work incentives advisement responsibility.

<b>CWICs should:</b>	<b>CWICs should NOT:</b>
<ol style="list-style-type: none"> <li>1. Explain the effects of self-employment income and business ownership on SSI, Social Security disability benefits, Medicaid, Medicare and all other public assistance programs.</li> <li>2. Prepare a detailed, written Benefits Summary &amp; Analysis to spell out how self-employment will impact benefits.</li> <li>3. Provide specific advice about use of work incentives in self-employment, based upon the unique needs of the individual.</li> <li>4. Teach beneficiaries how work incentives may be used to help fund self-employment.</li> <li>5. Provide specific advice about, and assistance with the use of a PASS in establishing a business.</li> <li>6. Facilitate the development of a PASS to include coordinating with SSA PASS specialists to facilitate approval of the plan.</li> <li>7. Act as an intermediary with business advisors to help them understand how work incentives may be applied to help establish a business.</li> <li>8. Act as an intermediary with accounting or bookkeeping professionals to help them understand specific accounting needs related to Social Security benefits.</li> <li>9. Follow up periodically with beneficiaries pursuing self-employment with active PASSes to see that everything is going as planned.</li> </ol>	<ol style="list-style-type: none"> <li>1. Attempt to talk beneficiaries out of pursuing self-employment due to the complex inter-relationship between business ownership and public benefits.</li> <li>2. Simply refer the beneficiary to local SBDC or SBA without fulfilling the responsibility for assisting with the Benefits Summary &amp; Analysis.</li> <li>3. Try to develop, edit, revise or in any way oversee or manage the writing of the business plan. CWICs are simply NOT trained to assist with this process.</li> <li>4. Write the entire PASS in isolation of the beneficiary. The PASS belongs to the individual with the disability – not the CWIC. Substantial involvement from the beneficiary is necessary if the PASS is to be successful.</li> <li>5. Take responsibility for setting up business accounts, reporting estimated earnings to SSA or keeping track of PASS expenditures. The CWIC’s role is to teach the beneficiary to do these things.</li> <li>6. Provide work incentives planning and assistance services to individuals who are withholding information about income and resources from SSA or misrepresenting net earnings from self-employment to any agency administering public benefits programs.</li> </ol>

## **REPORTING SELF-EMPLOYMENT INCOME TO SSA**

It is critically important for CWICs to invest time and energy into teaching self-employed beneficiaries what income needs to be reported to SSA and how exactly to perform this reporting. The overwhelming majority of benefits problems CWICs deal with on self-employment cases are directly related to failure to report or reporting inaccurate information. Beneficiaries cause themselves problems by not keeping their books on a regular basis and not getting their taxes prepared in a timely fashion. Remember, it is NESE that SSA cares about – not gross income or even gross profit from the tax returns – certainly NOT “owner’s draw”. Countable NESE may be further reduced by applying work incentives. In order to report NESE accurately, the beneficiary must retain receipts and track income and expenses in an organized fashion.

Here are some practical tips on reporting self-employment income which CWICs should be imparting to beneficiaries.

### **Reporting Tips for Title II Disability Beneficiaries**

**Practical TIP #1** – Beneficiaries must keep business financials on a calendar month basis during the TWP. The beneficiary should track profit and should know when profits have exceeded the applicable TWP guideline. Sending in month-by-month P&L states will work for this reporting.

**Practical TIP #2** – Beneficiaries should track all hours spent operating the business on a calendar month basis. Beneficiaries must be aware that TWP months may be used even if the business loses money if more than 80 hours are spent on running or working in the business in a calendar month.

**Practical TIP #3** – Even after the TWP ends, monthly financial statements are still the preferred way for beneficiaries to track their profits or losses for the purposes of SGA determinations. Beneficiaries should be closely monitoring profits on a monthly basis and comparing countable NESE with the applicable SGA guideline. If countable monthly NESE begins to exceed the current SGA guideline, it is advisable to submit the profit and loss statements to SSA and request that a work CDR be conducted. If the beneficiary waits until the tax year ends before reporting profits to SSA, it is possible that a large overpayment could occur. Even if the business loses money, it is essential to get taxes prepared promptly and to submit them to SSA for review.

**Practical TIP #4** – NEVER report gross sales or gross receipts from the business to SSA! Beneficiaries must retain all documentation of work incentives and should submit the Work Activity Report for self-employment (SSA Form 820) with the monthly profit and loss statements. Completed tax returns should also be submitted to SSA each year as soon as they are prepared.

### **Reporting Tips for SSI Recipients**

**Practical TIP #1** – SSI recipients are required to notify SSA when self-employment is initiated, even if no profits are generated.

**Practical TIP #2** – Since the SSI payment may be adjusted by estimated profits in the initial year of business operations, it is essential to supply an accurate initial estimate to SSA. Recipients should be conservative in their estimate to avoid having the cash payment reduced too much. Profits should be carefully monitored on a month-to-month basis and the estimate should be adjusted based upon actual countable NESE that is produced.

**Practical TIP #3** – After the initial year of operations, watch out for using projected NESE! SSA will estimate annual income based on these projections and will adjust the SSI payment accordingly. If the projections are inaccurate, overpayments or underpayments will occur.

**Practical TIP #4** -- When estimates are used to adjust the SSI cash payment, the beneficiary must diligently and carefully track actual NESE and adjust the projections quarterly as needed.

### **Common Mistakes CWICs Make in Reporting NESE**

1. GROSS income is NOT what SSA counts – it is countable NESE. Beneficiaries should never report gross income to SSA when they are self-employed.
2. PASS funds are NOT counted as income to the business. They are counted as owner investment and are not reportable to the IRS as part of the business tax returns.
3. Claiming personal expenses as business expenses is not permitted by either SSA or the IRS. There must be a legitimate business purpose for the expense to be deducted legally. When in doubt, beneficiaries should get the advice of a qualified tax professional.
4. Mixing business and personal funds is a VERY common problem for self-employed beneficiaries. Funds must be kept separate to meet both SSA and IRS requirements.

### **FINAL WORDS ON SUPPORTING BENEFICIARIES TO ACHIEVE SELF-EMPLOYMENT GOALS**

There are some significant differences in the way that SSA treats income derived from self-employment as opposed to wage employment and CWICs are expected to have a complete understanding of these differences. While self-employment cases may be rather complicated and may be a bit intimidating for new WIPA personnel, they cannot be avoided and must be pursued with the same diligence as wage employment cases. This unit is intended to serve as a starting point for developing competence in the provision of high quality WIPA services to beneficiaries who wish to become self-employed. There will undoubtedly be cases that will require additional research and extended support from the WIPA National Training Center personnel. CWICs are encouraged to seek such support whenever questions arise.

### **CONDUCTING INDEPENDENT RESEARCH**

Section	Latest Transmittal
<u>DI 10510.000</u>	Evaluation and Development of Self-Employment
<u>DI 10510.001</u>	SGA Evaluation and Development of Self-Employment
<u>DI 10510.010</u>	SGA Criteria in Self-Employment
<u>DI 10510.012</u>	Determining Countable Income
<u>DI 10510.015</u>	Test One of General Evaluation Criteria: Significant Services and Substantial
<u>DI 10510.020</u>	Income
	Tests Two and Three of General Evaluation Criteria: Comparability of Work and
<u>DI 10510.025</u>	Worth of Work Test
<u>DI 10510.030</u>	Documenting Self-Employment Cases
<u>DI 10510.035</u>	Completion of SSA-820-F4 (Work Activity Report — Self-Employed Person)
<u>DI 10510.040</u>	SSA-820-F4 Identification Items
	SSA-820-F4 — Work Activity Report — Self Employed Person

- SI 00820.200 - Net Earnings from Self-Employment (NESE)
- SI 00820.210 - How to Determine Net Earnings from Self-Employment (NESE)
- SI 00820.220 - How to Verify Net Earnings from Self-Employment (NESE)
- SI 00820.230 - How to Estimate NESE for Current Taxable Year

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# So, you want to be self-employed! Have you thought about...

## ... **business feasibility?**

How do you know that your business idea will work? Have you done any test marketing or have you talked to knowledgeable people about whether or not your business idea has a reasonable chance for success?

## ... **capitalizing business start-up?**

Do you know how much it will cost to start your business? Do you have any ideas about how to get the money you think you will need?

## ... **developing a written business plan?**

If you plan to apply for a loan, submit a Plan for Achieving Self-Support (PASS) or to ask the State VR Agency for funds, you will probably need a formal written business plan. Can you develop this document yourself or will you need help?

## ... **business structure?**

This refers to the legal structure your business will take such as a corporation, partnership, Limited Liability Company (LLC) or sole proprietorship. Business structure decisions are important because the structure of your business affects how SSA looks at any income your business generates as well as how taxes are assessed.

## ... **accounting and book keeping?**

Being self-employed requires that you keep track of business income and expenses. Do you plan to do your own bookkeeping and accounting or will you use the services of a professional? Have you looked into the cost of accounting software or the services of a book keeper/accountant? Will you need training to perform your own accounting?

## ... **tax implications of self-employment?**

When you are self-employed you still have to pay your Social Security tax (FICA), Medicare tax, and all other Federal, State and local taxes. Do you know what the requirements are in this area?

## ... **licenses, permits or other legal requirements?**

Will your business require any licenses or permits so that you can operate legally in your community? Do you know what paperwork needs to be filed to meet the Federal, State or local tax requirements?

## ... **accommodations you might need to operate your business successfully?**

Have you thought about what services and supports you might need to accommodate your disability as you manage your business? If you need

services or supports because of your disability, do you know where to go to get help arranging and paying for with these?

**... how self-employment will affect your SSA disability benefits?**

Profits from a business do count when the Social Security Administration looks at your earned income. As you move forward with your small business plans, make sure you stay in touch with your local WIPA project for assistance with SSA benefits issues

# **Outline of a Business Plan- From POMS SI 00870.026 Business Plans**

## **1. Overview of the outline**

The items at [SI 00870.026C.2.](#) - [SI 00870.026C.7.](#), follow an outline of a business plan, and identify the kinds of information that, at a minimum, a business plan must contain.

## **2. Title page**

The business plan should start with a title page. The title page should provide the following:

- The words, “Business Plan”
- Name of business and owner's name
- Owner's address and telephone number

## **3. Table of contents**

The business plan should have a table of contents listing the various parts of the plan. The pages should be numbered.

## **4. General description of business**

This part of the business plan should describe the business the person is interested in starting. It should answer the following questions:

- What services or products will be offered?
- What name will the business go by?
- Where will the business be located?
- Why was this business chosen?
- What skills and experiences does the individual bring to this business?
- What are the person's goals for this business?
- What is the action plan to achieve these goals?

## **5. Marketing the business**

### **a. Product and service description**

This section should answer the following:

- What is the product or service of the business?
- What demand is there for that product or service?



## **b. Description of market**

This section of the business plan should provide information about the businesses or people who will be buying the goods or services produced by the business. This section should provide answers to questions such as:

- Who is the customer?
- How does the individual know?
- Is the business involved in a fad or part of a trend?
- How does the individual expect the market to grow or change over the next few years?

Additionally, the section should describe any market research studies by industry experts or research the individual has done.

## **c. Competition**

This section should list the business' competitors and identify their strengths and weaknesses. It should compare prices, product quality, etc., and explain the advantages the business will have over the competitors.

## **d. Selling strategy**

This section of the plan should provide information as to how the business will go about pricing and selling the goods or services. It should provide information to questions such as the following:

- How will the business deliver the product or service?
- How will the product or service be priced? Based on what?
- What advertising will the business do?
- What marketing promotions will the business do?

## **6. Organization**

This section should provide information about the operation, including the management, of the business.

### **a. Production**

This section should provide details concerning how the product will be made or how the service will be performed. It also should clarify who will make the product or perform the service by answering questions such as:

- Who will do the work?
- How many people will be involved?
- What relationship, if any, do the people have to the individual owner?

- Where will the work be done?
- When will business begin making product or providing service?
- What is expected rate of production or frequency of service?

## **b. Quality control**

This section should provide information regarding the process to ensure the quality of the goods or services by providing answers to questions such as:

- How will the business assure quality?
- What is the industry standard? (Describe it.)
- How will the business be competitive if it can't match or better the industry standard?

## **c. Legal structure**

This section should provide the particulars about the legal form of the business; i.e., whether it is to be a sole proprietorship, partnership, or incorporation. It should identify whether more than one person owns the business and include any agreements. It also should identify any permits or licenses needed.

## **d. Management**

This section should identify the people involved in running the business by providing answers to questions such as:

- How will the business be managed day-to-day?
- Who will be responsible for monthly financial records? Will an accountant be involved?
- How will management change in the future?
- How will the business records be maintained?
- Will an attorney be involved?
- Are there other people to turn to for good advice? Who are they and what is their relationship to individual?

## **e. Other issues**

This section should include any other issues that are pertinent to the business, such as the type and amount of insurance to be carried by the business.

# **7. Financial plan**

## **a. Costs**

This section should provide details regarding the expected costs for the business. It should provide answers to questions such as:

- How much will the worker earn? Will production be timed and priced by unit or task completed per hour?
- What equipment and supplies will the business need?
- What resources does the business have available?
- What financing will be needed for the business? See e. below if the business plan is part of a request for a loan.

## **b. Cash flow projections**

This section should include monthly projections. These projections should include the individual's "best guess," giving "high side" and "low side" numbers.

## **c. Operating budget**

This section should provide a monthly budget for the first year. It also should include profit and cost estimates for the duration of the PASS and at least a year beyond its expected completion.

## **d. Supporting material**

This section should include any documentation to support the prior statements made about the business. Although not all inclusive, it should include such items as: brochures, business cards, summaries of market research studies, and references from people who know the individual or the business.

## **e. Purpose and amount of loan**

- If a loan is to be sought, this section should provide information relative to the following:
- How much money is the business looking to borrow from a third party? How will the money be used?
- Does the individual have any credit problems? If yes, the problem should be described and an explanation included as to how the problem has been or will be resolved.

**NOTE:** If there have been any discussions with the third party, the PASS should describe the outcome of the discussions.