

**NORTH DAKOTA DEPARTMENT OF HUMAN SERVICES
BISMARCK, NORTH DAKOTA
November 27, 2013**

IM 5192

TO: County Social Service Directors
Economic Assistance Policy Regional Representatives
Economic Assistance Policy Quality Control Reviewers

FROM: Carol Cartledge, Director, Economic Assistance Policy

SUBJECT: Standardized EAP Self-Employment Policy

PROGRAMS: Child Care Assistance Program (CCAP), Low Income Home Energy Assistance Program (LIHEAP), Supplemental Nutrition Assistance Program (SNAP), Temporary Assistance for Needy Families (TANF)

EFFECTIVE: January 1, 2014

RETENTION: Until Manualized

SECTIONS AFFECTED:

- CCAP – 400-28-05 – Definitions
- CCAP - 400-28-65-10-35 – Self-Employment
- CCAP – 400-28-65-10-35-05 – Documentation/Verification of Self-Employment Income
- CCAP – 400-28-65-10-37 – Corporation and Partnerships

- LIHEAP – 415-25-05-20-20 – Other Income
- LIHEAP -415-25-05-25 – Self-Employment Income (including all subsections)

- SNAP – 430-05-30-45 – Corporations (including all subsections)
- SNAP – 430-05-30-50 - Partnerships
- SNAP – 430-05-30-55 – Self-Employment (including all subsections)

- TANF – 400-19-05 - Definitions
- TANF – 400-19-55-15-25 – Earned Income From Self-

Employment
TANF – 400-19-55-15-25-05 – Documentation/Verification
of Self-Employment Income

CCAP, LIHEAP, SNAP and TANF have developed a standardized policy for determining self-employment income and unearned income as a result of self-employment. A new EAP Self-Employment Worksheet and EAP Anticipated Self-Employment Worksheet have been developed in Excel. They are available on the county intranet in the Economic Assistance-Health Care Coverage, EAP Self-Employment folder.

The Self-Employment Work Screen (SEEW) in TECS can no longer be used to calculate self-employment income for SNAP. The worker will need to enter the income calculated using the EAP Self-Employment Worksheet or the EAP Anticipated Self-Employment Worksheet on the Self-Employment Income (SEEI) screen.

Until a change can be put into Vision for TANF, contact TANF policy for instructions when processing cases with self-employment.

The exceptions to the standardized policy for self-employment are:

- Self-employment policy for treatment of assets for each program has not changed.
- SNAP will continue to offset losses based on policy at 430-05-30-55-25.

The standardized policy is effective by program as follows:

- CCAP – For new applications and reviews received on or after January 1, 2014. For ongoing cases, there are no changes made to the self-employment income until review unless an individual with self-employment income is added to the child care assistance unit.
- LIHEAP – For new applications received on or after January 1, 2014. For ongoing cases, income and assets should be reviewed as part of a mandatory reportable change.
- SNAP – For new applications and reviews received on or after January 1, 2014. For ongoing cases, the new policy will be used in determining the effect on the benefit if the household reports new self-employment or a change in self-employment that requires recalculation of self-employment income.

- TANF – The standardized policy is effective January 1, 2014. This policy applies to the self-employment income that is used to determine prospective eligibility for January 2014 and to the January 2014 income which will be used retrospectively to determine the March 2014 benefit.

Self-Employment

An individual who is working for themselves, rather than for an employer, is considered self-employed. The individual may be a contractor, franchise holder, owner/operator, partner, etc. The individual must meet the following criteria to be considered self-employed:

1. Earn the income directly from business or trade, not from wages or salary from an employer.
2. Be responsible for the payment of entire Social Security and Federal withholding taxes. [If an employee, the employer would pay half of their Social Security Tax and withhold federal income tax from the employee's salary.]
3. File self-employment tax forms, however, not all individuals file tax forms. In these special circumstances, income must be anticipated.

Calculating Self-Employment Income

Self-employment income is normally calculated by completing the EAP Self-Employment Worksheet using data from tax forms as verification.

Information for each business must be calculated separately. When a household has filed self-employment income taxes the income is determined as follows:

- If the income **represents a household's annual income, the income must** be annualized over a 12-month period of time, even if the income is received within a shorter period of time during those 12 months.
- If a self-employment enterprise has been in existence for less than a year and continues to operate, the income must be averaged over the period of time the business has been in operation.
- If an individual is self-employed for only part of the year to supplement their income from regular employment, the self-employment income must be averaged over the period of time it is intended to cover rather than a 12-month period.

Example:

An individual may be a self-employed painter during the three summer months and works as a housekeeper for regular wages the rest of the year. The self-employment income from painting is averaged over the three summer months because it is intended to meet the individual's needs for only part of the year.

When the total business 'profit' as calculated above results in a loss:

- For CCAP, LIHEAP and TANF, zero income will be used. A loss from a self-employment business cannot be used to offset or reduce income from other self-employment or other sources such as earned income.

- For SNAP, losses are offset based on policy at 430-05-30-55-25.

Anticipating Self-Employment Income in Special Circumstances

When a household has not filed a self-employment income tax return or there has been a significant increase or decrease in the operation of the business, income tax forms, monthly ledgers or bookkeeping records may be used as verification. The income is determined as follows:

1. Business Not In Operation a Complete Calendar Year or Tax Forms Not Filed
 - a. The applicant will need to provide monthly income and expense ledgers to anticipate self-employment income and unearned income as a result of self-employment. The EAP Anticipated Self-Employment Worksheet will assist with determining the monthly net farming and business income.

2. Partial Liquidation of Business
 - a. If a business sells some land, equipment, or other capital items to obtain money for current operating expenses and/or pay off a loan, and does not expect a substantial reduction in self-employment income as a result of the sale, continue to look at the most recent income tax forms.

 - b. If the business liquidates a large enough portion of the business to result in an anticipated substantial reduction in the self-employment income, the income tax forms must be appropriately adjusted to accurately anticipate the current year's income using the most recent income tax forms. Income and expenses (other than depreciation and depletion) for the portion of the business that is not being liquidated is used to determine net self-employment income.

Capital gains/losses on sale of property are counted as income.

NOTE: Use only the income or loss from the sale of capital items that can be reasonably anticipated to recur during the current year.

- c. If the business expects to liquidate partially but has not done so yet, use the most recent income tax forms in their entirety until the liquidation takes place.

3. Significant Increase or Decrease in Operation

A farm or business may have a significant increase or decrease in operation that is temporary and does not result in liquidation of the business. In these cases, one of the following methods must be used:

- a. If the applicant has had an estimated tax return prepared for the current business year, use the estimated tax return forms to complete the EAP Self-Employment Worksheet.
- b. If the applicant has prepared documents (such as farm plans) from a lender or bank or monthly income and expense ledgers, these documents may be used to arrive at the current year's anticipated income and expenses. The EAP Anticipated Self-Employment Worksheet will assist with determining the monthly net farming and business income.

Anticipated capital gains/losses on sale of property are counted as income.

4. Termination Of Business

- a. If a business expects to completely liquidate but has not done so yet, continue to use the most recent income tax forms or one of the methods described in #3 above until the business has liquidated.
- b. If a business has been completely liquidated, tax forms cannot be used to evaluate the applicant's income. Use only whatever income is currently available from other sources.

Treatment of Self-Employment Income

When an individual is actively engaged in a self-employment business, the income they receive is considered earned income. The following types of income are always considered earned income:

- Capital or Ordinary Gains/Losses
- Farm Income
- Business Income
- Partnership – Ordinary income, guaranteed payments to partners, depreciation and depletion

However, there are some types of income included on the self-employment income tax forms that are considered unearned income. The following types of income are always considered unearned income:

- Royalty income
- Cooperative distributions (patronage dividends)
- Partnership – rental, interest and dividend income
- Income from S-Corporations
- Estate or trust income

The following types are considered earned or unearned depending on whether the individual is actively engaged in earning the income and the self-employment tax forms filed.

- Farm rental income
- Other rental income

The earned income must be separated from the unearned income and will be when using the self-employment calculation worksheet.

Determining Self-Employment Income

1. Capital or Ordinary Gains or Losses – A capital or ordinary gain or loss is the difference between the sale price and the cost basis. The cost basis may include improvements and sales expenses such as broker's fees and commissions.

Capital or ordinary gains or losses are considered part of the **EARNED** income from self-employment. The gain or loss is calculated by deducting the cost basis from the gross sale price. The result is then added to or subtracted from the calculation of the self-employment income for the business the property was used in.

NOTE: Use only the income or loss from the sale of capital items that can be reasonably anticipated to recur during the current year.

This income is generally included on the Schedule D or Form 4797.

2. Farm Income – Income earned through the operation of a farm or ranch including farm rental income and CPR.
 - a. Farm Rental Income – Income received by a landowner from the sale of crops or livestock produced by the tenant. This does not include cash rent of pasture or farmland.
 - b. Conservation Reserve Program Payments (CRP) – Cost share and payment program under the USDA that encourages farmers to convert highly erodible crop land or other environmentally sensitive acreage to vegetative cover.

Farm income, including farm rental income and CRP:

- Is considered **EARNED** income when the individual is actively engaged in farming. The total farm income or loss is determined by taking the taxable amount of cooperative distributions (patronage dividends) from the net farm income and adding in the depreciation.

The amount of cooperative distributions is deducted from farm income as it is considered unearned income. Depreciation is added back in as this is not an allowable expense.

This income is generally included on the Schedule F.

- Is considered **UNEARNED** income as a result of self-employment when the individual is NOT actively engaged in farming. The total farm rental income or loss is determined by taking the taxable amount of cooperative distributions (patronage dividends) from the net farm rental income and adding in the depreciation.

The amount of cooperative distributions is deducted from farm rental income as it is considered unearned income on a separate line in the calculation. Depreciation is added back in as this is not an allowable expense.

This income is generally included on the Form 4835.

3. Business Income – Income earned through the operation of a business other than farming or ranching.

Business income is considered **EARNED** self-employment income. Business income is determined by taking the net business income profit or loss and adding in the depletion or depreciation. Depreciation and depletion are added back in as they are not allowable expenses.

This income is generally included on the Schedule C.

4. Partnerships – A partnership is a self-employment business set up as a partnership with two or more partners. A partner's share of income, gain, loss, deductions or credits is determined by a partnership agreement.

- Ordinary income and guaranteed payments to partners in a partnership are considered **EARNED** self-employment income. This income is generally included on the Schedule K-1 (Form 1065). The partner's share of the partnership income is determined by adding the partner's share of depreciation or depletion to their ordinary income and guaranteed payments. Depreciation and depletion are added back in as they are not allowable expenses. The depreciation and depletion are generally included on the Form 1065.
- Rental, interest and dividend income paid to partners in a partnership are considered **UNEARNED** income as a result of self-employment. The partner's share of the partnership income is the total of the rental, interest and dividend income. This income is generally included on Schedule K-1 (Form 1065).

5. Other Rental Income – Income received from the cash rental of property.

Other rental income is considered **UNEARNED** income as a result of self-employment. Rental income is determined by taking the total net rental income from all rental properties and adding in the depreciation or depletion. Depreciation and depletion are added back in as these are not an allowable expense. This income is generally included on Schedule E.

6. Royalty Income – a percentage of gross or net revenues derived from the use of an asset or a fixed price of a unit sold of an item.

Income individuals receive from royalties is considered **UNEARNED** income as a result of self-employment. Royalty income is generally included on Schedule E.

7. Cooperative distributions (patronage dividends) - are paid by cooperatives in cash or shares of stock. These dividends are similar to rebates paid based on the amount of goods bought or services used for the self-employment enterprise.

Income individuals receive from cooperative distributions or patronage dividends is considered **UNEARNED** income as a result of self-employment. Cooperative distributions or patronage dividends are generally included on Schedule F and Form 4835.

8. S -Corporation - a separate business entity with 1 to 100 shareholder(s) that passes through the net profit or loss to their shareholder(s). The business profits are taxed at individual tax rates on each individual shareholder's income tax.

Income shareholders receive from a corporation is considered **UNEARNED** income as a result of self-employment. This income is generally included on the Schedule K-1 (1120S). The shareholder's income is determined by adding the shareholder's share of depreciation or depletion to their ordinary business income, net rental real estate income, interest income and dividend income. Depreciation and depletion are added back in as these are not an allowable expense. Depreciation and depletion are generally found on the Form 1120S.

NOTE: An owner or employee of a corporation is not a self-employed individual because the business income and liabilities belong to the corporation, not the individual. Wages that an owner or employee receive from a corporation are considered earned income.

9. Estate or Trust Income - Income received from an estate or trust.

Income individuals receive from estate or trusts is considered **UNEARNED** income as a result of self-employment. Estate or trust income is generally included on Schedule E.

Other Types of Self-Employment Income

The following types of income may or may not be listed on self-employment tax forms. If the income is not listed on the self-employment tax forms, the income must be verified separately.

1. Qualified Service Provider (QSP) – Qualified Service Providers (QSPs) are individuals who provide care for people who want to continue to live in their own homes and communities. QSPs do not need to have a special certificate or license, but they do need to prove they have the skills to provide care.
 - QSP income is considered **EARNED** self-employment income when the individual is not an employee of an agency.
 - QSP income is considered regular earned income when the individual is employed by an agency.
2. Boarder - Individuals or groups of individuals residing with others and paying reasonable compensation for lodging and meals.

Income from boarders is considered **EARNED** self-employment income when the individual providing the board is actively engaged in providing the lodging and meals and the boarder is not included in the household based on program policy.

To calculate income from room and board, take the monthly gross receipts less \$100 per boarder.

Wages Paid to Family Members

Wages paid to family members are an allowable business expense. However, the wages paid to family members must be counted as earned income separately from self-employment income unless the earned income is specifically excluded by program policy.

The income tax forms identify wages paid to family members as wages or labor hired but does not separate outside labor hired from wages paid to family members. The household will need to identify and verify the amount paid to family members (cancelled checks, W-2 forms, bank books showing transfer of funds).

Allowable Expenses

The following expenses are allowable deductions from self-employment income. Because the EAP Self-Employment Worksheet uses net income any

of these expenses claimed on the tax form are already deducted. The Anticipated Self-Employment Worksheet also accounts for these expenses.

If a household verifies any of the following expenses incurred as a result of self-employment income that were not included on the tax forms, the expense must be allowed by deducting it from the net income.

- Advertising
- Car and truck expenses
- Chemicals
- Commissions and fees
- Conservation expenses
- Contract labor
- Custom hire (machine work)
- Employee benefit programs
- Feed
- Fertilizers and Lime
- Freight and Trucking
- Gasoline, Fuel and Oil
- Insurance (other than health)
- Interest (mortgage and other)
- Labor hired
- Legal and professional services
- Office expenses
- Pension and profit-sharing plans
- Rent or lease (vehicles, machinery, equipment, business property, land, animals)
- Repairs and maintenance
- Seeds and Plants
- Storage and Warehousing
- Supplies
- Taxes (Real estate, employer's match of payroll taxes, contributions to state unemployment insurance, licenses)
- Travel, meals, entertainment
- Utilities and phone
- Veterinary, breeding and medicine
- Wages
- Other expenses such as:
 - Bad debts
 - Bank service charges
 - Dues and publications
 - Laundry and cleaning
 - Tools

- Day care meal expenses (if not reimbursed through a food program)

Non-Allowable Expenses

The worker must determine if an expense is non-allowable based on whether the expense is part of producing income. The following expenses are not allowable deductions from self-employment income:

- Expenses and net operating losses (NOL) from previous periods.
- Depreciation/depletion - to allow these costs would result in exclusion for amounts that are not actual costs.
- Other expenses that are not incurred as a result of self-employment income, such as:
 - Charitable contributions
 - Penalties and fines