



## TANF 503-1 Self-Employment Income

**Supersedes:** TANF 503-1 (1/1/08)

**Reference:** ARM 37.78.402, .415 and .421

**Overview:** Net earnings from self-employment must be counted when determining eligibility.

### **SELF-EMPLOYMENT:**

So long as a profit motive exists, an individual does not have to make a profit to be in a trade or business. The individual may be a contractor, franchise holder, owner/operator, partner, etc. They must meet the following criteria to be considered self-employed:

1. They earn their income directly from their business or trade, not from wages or salary from an employer;
2. They are responsible for the payment of their entire Social Security and Federal withholding taxes;
3. They do not have an employee/employer relationship with another individual and the services he/she performs cannot be controlled by an employer;
4. They should file self-employment tax forms. However, not all individuals file tax forms and some may file incorrectly; and
5. They “materially participate” in the production of the income in that their direct activities cause the income to be produced. When an individual materially participates in a self-employment business, the income generated is directly affected by the number of hours the individual works.

### **SELF-EMPLOYMENT STRUCTURES:**

There are many types of self-employment structures. Some of the most common structures include:

1. **Sole Proprietorship:** A self-employment business that is not incorporated and has one or two owners. The business income and liabilities are responsibilities of the one or two owners. (Limited liability companies—LLCs—are not sole proprietorships.)
2. **Partnership:** A self-employment business that is set up with two or more partners. In addition to personal income tax forms, partnerships are also required to file 1065 and K-1 forms. The business income and liabilities are the responsibility of all the partners, with the partnership defining shares of ownership and responsibility. Partnership income is

determined in the same way as other self-employment. (Limited liability companies and limited partnerships do not meet this definition.)

3. Independent Contractor: An individual who pays his or her own employment taxes and does not have an employee/employer relationship is considered self-employed. Independent contractors should be registered with the State through the Department of Labor and Industry.
4. Sharecropper: If the sharecropper pays the costs of doing business and receives a portion of the net income in exchange for his/her labor, s/he is considered self-employed. However, if the sharecropper is not responsible for paying the costs of doing business, s/he is not considered self-employed.

### **CORPORATIONS:**

Income earned from a corporation is not considered self-employment income. Income received by an individual who works for the corporation is considered countable wages.

Incorporated businesses are not self-employment enterprises. Any corporate income reported on Schedule E, Line 31 as income received from a corporation must be annualized and used as countable unearned income even if the household did not receive the money. Any loss reported on Schedule E, Line 32, as loss received from a corporation is not used in any budget calculation.

Although wages paid to corporate officers are considered wages, fees paid to corporate directors are considered self-employment earnings.

### **LIMITED LIABILITY COMPANIES AND LIMITED PARTNERSHIPS:**

Limited liability companies (LLCs) and limited partnerships are treated like corporations for eligibility purposes, regardless of what tax documents may be filed with the IRS. Income other than “guaranteed salaries” received from a limited liability company or partnership is unearned income. No income from an LLC or limited partnership is net earnings from self-employment.

### **ACTIVITIES THAT ARE NOT SELF-EMPLOYMENT:**

The following income is not considered self-employment. These are unearned income sources:

1. Rental self-employment income and rental partnership income where the individual is not materially participating in the business at least 20 hours per week or is not reporting the income as self-employment on Schedule C or F of their federal tax return (instead, passive rental income is often filed on Schedule E);
2. Contract for deed income;
3. Boarder income, in some instances; or
4. Income received by a non-participating investment partner in a business (also known as a “silent partner”).

The above types of income are known as passive income.

### **INCOME EXCLUSIONS:**

Exclude the following:

1. Federal gasoline tax credit;
2. State gas tax;
3. Disaster payments; and
4. Crop insurance payments.

### **PATRONAGE DIVIDENDS:**

Patronage dividends paid to a self-employment enterprise are countable as part of self-employment income as a whole, even if paid in stock. Resources that have been prorated as income are excluded as resources during the period over which they are prorated as income.

### **AGRICULTURAL STABILIZATION & CONSERVATION SERVICES (ASCS):**

Cash payments are counted as earned self-employment income. These include but are not limited to:

1. Commodity Credit Corporation;
2. Acreage reduction; and
3. Conservation payments and other one-time or installment payments made to farmers for crop or other losses unrelated to a presidentially declared disaster.
  - a. If the payment is due to a presidentially declared disaster it is excluded as both income and a resource due to the Disaster Relief Act.

### **CANCELED DEBT:**

Canceled debt is used in determination of net earnings from self-employment if included on tax forms. Do not routinely question information on tax forms unless an amount seems unreasonable.

### **CAPITAL GAINS CAPITAL LOSSES:**

Capital gains are increases in the value of property between the time purchased and the time sold. Capital losses are decreases in the value of property between the time purchased and the time sold. For self-employment businesses, depreciation plays a role in determining whether capital gains/losses occur. Capital gains/ losses are normally determined at the time property is sold.

Capital gains from the sale of self-employment property must be annualized as part of the net earnings from self-employment regardless of whether paid in a lump sum or in installments. Capital gains will only be included in prospecting self-employment income if capital gains are received or expected to be received prospectively for next year.

Capital losses are not used in any self-employment income determination. They are not considered business expenses or deductions.

### **CONTRACT FOR DEED:**

Payments received from a contract for deed that are excluded as a resource are considered countable unearned self-employment. The cost of doing business is deducted from the gross income to arrive at the countable net income. The income is countable over the period the income was intended to cover.

Allowable business expenses include: escrow fees, property taxes and insurance. The interest earned and the portion of the payment for principal, are countable income when the contract for deed is an excluded resource.

When the contract for deed is countable as a resource, only the interest payment (minus cost of doing business) is counted as income. The payment on principal is excluded.

### **IN-KIND INCOME & BARTERING:**

If the self-employment business (including a farm) provides all or part of a household's shelter and/or food, this may be earned or unearned in-kind support and maintenance, valued using the NMI standard for a household of one for shelter and the Food Stamp Thrifty Food Plan based on the household size for any food provided. This in-kind income may be earned or unearned, depending on if it is being provided to the individual who is self-employed (in which case it is earned) or to other household member(s) who do not work for the business (in which case it is unearned). If food and/or shelter is provided to an entire household, the value must be assigned as in-kind income among the household members.

Bartering is considered in-kind services exchanged between two self-employed businesses. The goods or services received in a bartering situation must be evaluated to determine whether they meet the requirements as countable income.

### **ALLOWABLE EXPENSES:**

Allowable expenses are excluded from self-employment income. Most costs of doing business are allowable expenses and may be accepted as listed on the income tax forms with few exceptions. Expenses must be current, not due from a previous fiscal period, and are only allowed when paid.

When anticipating self-employment income for a new business or significant change, expenses expected to be due and payable in the prospective period may be anticipated to offset the anticipated income.

Some self-employed individuals do not claim all expenses on their Schedule C in order to qualify for Earned Income Tax Credit. The allowable expenses that are not shown on the Schedule C can be verified by the applicant/client and should be used in determining accurate self-employment earnings.

Supplies are generally described as objects that will normally be used up or consumed in service.

Transportation costs for doing business may be allowed. However, the cost of commuting to the business from home is not allowed. Mileage expense is allowed at the Federal expense rate.

### **DEPENDENT CARE BUSINESS EXPENSES (Cost of Meals):**

Household's deriving income from dependent care may elect one of the following methods to determine the cost of meals provided to the individuals:

1. Actual documented meals;
2. A standard per day amount based on estimated meal costs; or
3. Current reimbursement amounts used in the Child and Adult Care Food Program.

**NON-ALLOWABLE EXPENSES:**

Non-allowable expenses must be added back into the self-employment income if income tax forms are used, or not allowed as a deduction in the monthly calculation of self-employment income.

The following are examples of non-allowable expenses:

1. Purchase costs of capital assets and durable goods, even if the capital asset or durable good is not set up on a depreciation schedule. Capital assets and durable goods are objects used in business that are expected to last a long time. All items purchased for a business prior to the opening of the business are capital expenses;
2. Repayment of loan principal (since the loan was never considered income); however, the interest payment on business loans may be deducted;
3. Federal, state, and local income taxes;
4. Depreciation, which is added back into income when it is used as a deduction from self-employment income. Self-employment forms must be reviewed to ensure that all depreciation expenses are captured. Common examples are: Schedule C, line 13; Schedule C-EZ, line 2; Schedule E, line 20; Schedule F, line 16; Form 8829, line 28; Form 1065 - 16a; or any income forms attached to the 1065, like Schedule F;
5. Social Security taxes;
6. Meal and entertainment costs; and
7. Transportation to and from work.

**IN-HOME BUSINESS EXPENSE:**

When the self-employment enterprise is conducted in the client's home and the household wishes to claim a portion of the shelter expense as a business deduction, separate business expenses from personal home expenses. The portion of the home that is used on an exclusive basis for a business is allowed as a business expense. However, the household is not required to use the business portion as a business deduction.

The following criteria must be met to use home shelter costs as a business expense:

1. A substantial amount of time must be spent doing business in the home (not occasionally).

If the in-home business is not related to dependent care, the business must also meet one of the following two conditions.

2. An allowance for space regularly used for inventory storage may be allowed if the space is identifiable and only used for self-employment; or
3. The portion of the home must be used on an exclusive basis.
  - a. The portion of the home cannot be used only for administrative work

With the applicant/client's agreement, determine the usage of home for business purposes by:

1. The household's calculation of use;
2. Income Tax Form breakdown (8829 percentage - only if the business and personal home costs are separated on this form);
3. The ratio of business square footage to square footage of the entire home; or
4. Other reasonable verifications submitted by the household.

Do not question the separation of business and home expenses on the income tax forms unless there is a question about the accuracy of the information. If this occurs, the amounts may be recalculated as directed above, or OPA may agree with the applicant/client to assign the value of the shelter as in-kind income to the household.

If a self-employed individual cannot (or will not) provide proof of his separate business and personal shelter expenses, no questionable expenses will be allowed in calculating self-employment income.

#### **BUDGETING:**

Self-employment income intended to support the household on an annual basis is annualized.

Temporary or seasonal self-employment income or when a business is not in operation for an entire year means the income does not represent annual support, and would be averaged over the period it is intended to cover.

The following self-employment incomes are always annualized regardless of whether or not the income is intended to support the household on an annual basis:

1. Farm income
2. Self-employment income received less often than monthly

When self-employment income is annualized, the expenses must also be annualized. Expenses are counted when paid, not when billed.

If the self-employment income is annualized, income tax forms should be used to determine income (when available). The most current tax forms must be used unless there is a substantial change in business or income. Income must be annualized whether or not tax forms reflect current income and whether or not they are available. Other documentation must be used to determine annualized income.

#### **NEW BUSINESS:**

If a new business, the income must be averaged using the income and expenses from the months the business has been in operation until 12 months have been reached. If there is no reliable history of

income or expenses to average, negotiate a projection of the anticipated monthly income and expenses with the applicant.

**RENTAL INCOME:**

Depending on how active an individual is in managing rental property, the income can be considered either earned self-employment or unearned income. Regardless of this designation, the cost of doing business is deducted from the gross income to determine net countable income for benefit calculation.

If the income is determined to be unearned, the countable is gross income minus the allowable expenses.

**ROOMERS:**

A roomer is an individual living with a household and paying for lodging but not meals.

Payments received from roomers will normally be considered unearned contributions to the household.

Do not allow expenses against the contributions unless the roomer situation meets the definition of earned income, in which case it is treated as self-employment.

Payments received from roomers will be offset by a pro rata share of the housing expenses based on the number of rooms rented compared to the number of rooms in the entire residence (excluding bathrooms and attics/basements unless they have been converted into living space).

**BOARDERS:**

Treat commercial boarding houses according to the general provisions of regular self-employment, rather than according to information provided below.

Foster children are not considered boarders.

When a boarding situation is not related to a commercial boarding house, the income is determined according to the following provisions.

Income from boarders includes all direct payments to the household including contributions for meals and shelter. In determining the amount of countable income received from the boarder, exclude the household's costs of providing room and meals to the boarder (allowable expenses).

The household may choose one of the following methods to determine the business expenses:

1. The actual documented allowable expenses related to providing room and meals, including a pro rata share of food, utilities, etc.; or
2. The amounts allowed when determining in-kind income for food and/or shelter.

**INCOME/LOSSES:**

Verified self-employment losses (not corporation losses) are deducted from other self-employment gains (earned or unearned).

Losses from corporations are not used to offset any other income.

### **BANKRUPTCY:**

If bankruptcy is filed, the projected monthly self-employment income continues to be used unless the household states the business will have substantial change in income and expenses. This statement would be verified with a statement from the bankruptcy trustee regarding the debt reorganization plan concerning the anticipated gross income and expenses.

The income will continue to be projected to the end of the business' fiscal year (unless the self-employed person has died), although the amount projected may change.

If the household reports that the self-employment enterprise has ended, the monthly self-employment income is no longer projected.

The self-employment income continues to count even if diverted to a bank or other source. If the self-employment income goes to a trustee, and the household receives a living allowance, the entire self-employment income continues to be budgeted and no deduction is allowed for the trustee or conservator's fees.

The living allowance is not counted as income because it is derived from the self-employment income already being counted.

If the equipment/land is repossessed or the title is given to the lender, the property is the legal property of the lender and sale of the property is not considered income. However, if the title remains in the household's name and the lender arranges the sale, the property belongs to the household and the amount is counted in the following way depending on the program involved:

1. Count as income if received as periodic payments; or
2. As a resource if received in a lump sum.

If the lender forgives or writes off a loan, the amount forgiven or written off is not considered income.

### **REPORTED CHANGES:**

A change in the amount of net income is substantial if the change will result in a difference of \$25/month or more to the prorated monthly net self-employment income for the entire period in which the income is countable. If there is no substantial change in operation or income and the source of income hasn't changed, but the household turns in the new income tax forms prior to redetermination, recalculate the self-employment income based on the new tax forms.

**Effective Date:** January 01, 2018