Self-Employment and Social Security Disability Benefits

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Introduction

There are several important reasons why the CWIC training manual includes an entirely separate unit on the effect of Self-Employment Income (SEI) on Social Security disability benefits. First, Social Security treats self-employment income differently than wages in both the SSI and Title II disability programs in some important ways and CWICs need to be aware of these critical differences. Second, several unique work incentives apply to self-employed individuals that don’t apply to individuals in wage employment. In addition, some work incentives that apply in both wage employment and self-employment situations apply differently when the beneficiary is self-employed. You will need to counsel beneficiaries who are pursuing a goal of self-employment or small business ownership on the unique manner in which self-employment income affects disability benefits and the ways in which an individual may apply work incentives to help achieve a self-employment goal.

Self-employment is an increasingly popular employment objective for individuals with disabilities because 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.

Telling the Difference between Wage Employment and Self-Employment

When providing WIPA services, there will be times when it’s difficult to determine if the earned income a beneficiary gets is from wage employment (i.e., an employer-employee relationship exists) or if the person is actually self-employed. Determinations about whether earned income
represents “wages” or “self-employment income (SEI)” can get very complicated. To add further difficulty, these issues don’t fall 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 determinations and often have overlapping laws and regulations. These determinations are critically important because the Title II and SSI programs treat various forms of income differently. If CWICs are unclear about whether income is wages or self-employment income, they may give incorrect information about how Social Security will treat it. In turn, this may cause a beneficiary to make a series of poor choices about work.

This unit isn’t designed to make CWICs experts in determinations of wage employment or self-employment. There are literally hundreds of POMS citations covering this topic, and the issues involve complex legal interpretations. The following sections will provide a general understanding of how wage employment and self-employment differ, and how Social Security decides which situation applies to a beneficiary with earned income.

**Social Security and the IRS make Independent Employment Determinations**

Social Security’s regulations state: “If there is a question about whether you are working as an employee or are self-employed, we or the Internal Revenue Service (IRS) will make a determination after examining all of the facts of your case.”

It’s important to understand that the IRS and the Social Security Administration have very different rules that govern these determinations. Social Security will make an independent employer-employee relationship determination to establish a worker’s coverage status or to resolve earnings discrepancies. The IRS makes an independent employer-employee relationship determination to establish a worker’s obligation to make Federal Insurance Contributions Act (FICA) contributions and for tax withholding purposes. Social Security doesn’t need to ask for copies of IRS determinations or rulings on employer-employee relationships. Social Security will make its own employment determination, regardless of whether or not there is an existing IRS determination. In addition, Social Security doesn’t defer to the IRS’ determination that a worker is, or isn’t, an employee. The IRS will make its employment determination based on tax liability. The Social Security employment determination is for social security coverage purposes. Because of this, it is possible for the IRS to consider a beneficiary to be self-employed for IRS purposes, but in wage employment for Social Security purposes, and vice versa. This can be very confusing for beneficiaries and CWICs!

**Social Security’s Procedures for Making Employment Determinations**

When a beneficiary’s employment situation is unclear, local SSA personnel may use Form SSA-7160 (Employment Relationship Questionnaire) to make an employment determination. The field office will request the worker and his or her alleged employer to complete this form to
determine the worker’s employment status. When possible, both the worker and the employer should complete the form independently of each other. In some cases, Social Security personnel may assist the worker and the employer in completing the form to ensure that they fully understand the questions. Form SSA-7160 is a questionnaire that gathers information from the worker and the alleged employer to determine the worker’s employment status using a set of rules known as the Common Law Control Test.

**Common Law Control Test**

Social Security uses common law rules to establish the status of a worker (e.g., employee, contractor, or self-employed) by determining whether a relationship exists between the worker and the person receiving the services. Social Security examines facts and circumstances of individual cases to determine the degree of control the employer has over the worker. The courts identified various factors that Social Security can use to determine if an employment relationship exists. These factors are described in detail in POMS RS 02101.000, which can be found online at: [https://secure.ssa.gov/apps10/poms.nsf/lnx/0302101020](https://secure.ssa.gov/apps10/poms.nsf/lnx/0302101020)

Social Security will consider an individual an employee if his or her relationship with the person receiving the services meets the common-law control test. Under this test, the individual is subject to control by the person receiving the services as to when, where, and how the work is done. The control doesn’t need to be exercised for an employer-employee relationship to exist; the right to exert such control is enough. In borderline cases, a determination as to whether an individual is subject to the right of sufficient direction and control by the person for whom the services are performed is often a difficult one to make. Social Security must examine the relationship of the business and the worker. The three categories of evidence and key facts that demonstrate the right to direct and control are:

**Behavioral control**
The following are examples of behavioral control:
- Worker receives instructions from the business
- Worker receives training from the business

**Financial control**
The following are examples of financial control:
- Method of payment — worker receives an hourly wage or salary rather than a lump sum payment for a particular task
- Worker doesn’t have the opportunity for profit or loss
- Worker doesn’t make his or her services available to the relevant market
- Worker doesn’t make significant investments
- Worker doesn’t have unreimbursed expenses
Relationship of the parties

Examples of relationships between a business and a worker:

- Discharge or termination — either business or worker can end the relationship before the job is completed
- Employee benefits (beyond monetary compensation)
- Intent of parties — written contracts that indicate both parties believe they are in an employer-employee relationship
- Worker’s services are a part of business’s regular business activity

A finding that an individual is an employee means the individual was subject to control over when, where, and how (the means and methods) to perform the work. This finding indicates that the employer has the right to direct and control the worker. Social Security determines a worker to be an employee when the majority of these conditions are met:

- The employer furnishes the worker with tools or equipment and a place to work. (However, some artisans such as carpenters and plumbers usually provide some or all of their own tools.);
- The employer may fire the worker;
- The employer pays the worker’s business or travel expenses;
- The employer sets the work hours, requires that the worker work full-time, or restricts the worker from working for others;
- The employer pays the worker by the hour, week, or month;
- The worker doesn’t hire, supervise, or pay assistants (unless employed as a foreman, manager, or supervisor);
- The worker must perform the job personally; and
- The worker receives training from the employer, or the worker must follow the employer’s instructions.
- A worker is self-employed when he or she meets the majority of these conditions:
  - Advertises his or her services to the general public;
  - May be liable for damages if he or she quits before completing the job;
  - Makes a profit or suffers a loss;
  - Pays his or her own expenses and provides the equipment and work place; and
  - Works for a number of persons or firms at the same time.

Determinations involving the common law control test can be complicated. CWICs should always refer beneficiaries to the local Social Security office for these determinations. A reader-friendly summary of the rules governing employment determinations can be found in the Social Security Handbook here: http://www.socialsecurity.gov/OP_Home/handbook/handbook.08/handbook-toc08.html266
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 the Social Security Administration may treat different forms of self-employment in different ways. Determining which form of self-employment a beneficiary is participating in can be very complicated. When in doubt, CWICs should refer the case to the local Social Security field office for assistance. The most prevalent types of self-employment are described below, but CWICs need to understand that many different situations may occur that Social Security may investigate on a case-by-case basis before making a determination.

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 many forms and owners can organize them under many different structures including sole proprietorship, partnership, limited liability companies (LLCs), and corporations. A beneficiary may be the only owner of a company or business, or may be one of a number of owners. Social Security considers an individual who owns a share of a business to be self-employed only when he or she performs some form of work or service for that business. It’s possible to be an investor in a business but for Social Security to not consider that person self-employed or receiving earned income, depending on what role the person plays within the business. Some very complicated rules apply to businesses that are incorporated and are explained later on in this unit.

Independent Contractors

An independent contractor is a person, business, or corporation that provides goods or services to another entity under terms specified in a contract or within a verbal agreement. Unlike an employee, an independent contractor doesn’t work regularly for an employer but works as and when required. Independent contractors usually receive pay on a freelance basis. In the United States, any company or organization engaged in a trade or business that pays more than $600 to an independent contractor in one year is required to report this to the Internal Revenue Service (IRS) as well as to the contractor. Independent contractors don’t have income taxes withheld from their pay as regular employees do. Independent contractors are responsible for their own self-employment tax.

In determining whether an individual is an employee or an independent contractor, Social Security applies the common control rule as previously described. When there is doubt about
whether or not a beneficiary is working as an independent contractor, always refer the person to the local field office for a determination. These determinations can be very complex, and CWICs aren’t authorized to perform them.

**Statutory Employees**

Statutory employees include workers from four occupational groups who perform services under certain prescribed circumstances. These workers can’t qualify as employees under the common-law rules, but their work conditions are so similar to those who do that Congress provided for their coverage as statutory employees, rather than as self-employed persons. Statutory employees include:

- Agent or commission drivers who deliver food or beverages (other than milk) or pick up and deliver laundry or dry cleaning for someone else;
- Full-time life insurance salespeople who sell primarily for one company;
- Home workers who work by the guidelines of the person to whom they are providing services; and
- Traveling or city salespeople who work full time for one company or person.

These workers are employees for Social Security coverage purposes when:

- They have no substantial investment in facilities to do the work (other than transportation);
- They perform services in a continuing work relationship; and
- The service contract contemplates that they will perform substantially all of the services personally.

For more information about statutory employees, refer to POMS RS 02101.300 - Statutory Employees, which can be found online at: https://secure.ssa.gov/apps10/poms.nsf/lnx/0302101300

**Statutory Non-Employees**

When workers don’t meet the qualifications of an employee under the common law control test, Social Security will likely consider them to be self-employed as independent contractors. However, under IRS statute, Social Security does NOT consider workers in the following three occupations to be employees if they meet certain qualifications:

- Companion sitters;
- Direct sellers; and
Real estate agents.

Section 3506 and 3508 of the Internal Revenue Code provide that these workers are “statutory non-employees.” This means the IRS treats them as self-employed for all federal tax purposes, including income and employment taxes, if a) 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 b) they perform their services under a written contract providing that the IRS will not treat them as employees for federal tax purposes. For more information about how Social Security views real estate agents and other similar salespeople, refer to RS 02101.200 Real Estate Agents and Salespeople found at https://secure.ssa.gov/apps10/poms.nsf/lnx/0302101200 and RS 01802.232 Real Estate Agents and Direct Sellers found at https://secure.ssa.gov/apps10/poms.nsf/lnx/0301802232. Again, CWICs don’t make these determinations, but should refer beneficiaries to the local field office. For more information, refer to the VCU NTDC resource documents titled “Determining when a Beneficiary is an Employee or Self-Employed,” which is available online here: http://www.vcu-ntdc.org/resources/resources.cfm269

Unusual Self-Employment Situations

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

Ministers and Members of the Clergy

Social Security typically considers services performed by ministers or other members of the clergy 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 shouldn’t show Social Security and Medicare wages or taxes because the beneficiary would pay these directly; the church wouldn’t withhold them. Ministers can receive a variety of things in exchange for ministerial duties, some of which count as earned income while others won’t. 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 part of the compensation package; and
• Travel and automobile allowances, although the minister can deduct these same items as business expenses he or she incurred in the performance of ministerial duties.

A minister excludes the following items from gross income:

• Pensions and retirement pay;
• Parsonage or housing allowances when the employer includes it in retirement pay after the minister retires, or any other retirement benefit the minister received after retirement pursuant to a church plan as defined in Section 414(e) of the Internal Revenue Code, Social Security must exclude 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 or her retirement pay, Social Security must exclude the parsonage allowance when determining NESE. However, if this same retired minister goes to work for Church B and it pays him or her a parsonage allowance, Social Security must include this new income when computing NESE.
• Gifts, unless they are part of the minister’s compensation.

CWICs must be careful when counseling beneficiaries who say they are members of the clergy, because there is so much variance in what this actually means. In addition, even when a beneficiary does meet Social Security’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 U.S. 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 Social Security field office for a formal determination.

Directors of Non-Profit Organizations

Beneficiaries sometimes want to start and manage a non-profit organization that they believe is a form of self-employment. In fact, Social Security doesn’t consider 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 as self-employed. A non-profit organization isn’t “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 an employee of the organization who reports to the board of directors.

Artists and Authors
Social Security 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. Beneficiaries begin some endeavors as hobbies with no intention of ever making a profit and as such, generally don’t constitute engaging in trade or business. For example, if a beneficiary receives a royalty payment based on products he or she made originally as part of a hobby, Social Security won’t consider the payments 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, Social Security might consider any income he or she derived 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 both the IRS and Social Security would count as earned income. Again, CWICs aren’t authorized to make determinations of this type. When any doubt exists, you should refer the beneficiary to the local Social Security field office for a formal determination.

Farmers

Social Security considers beneficiaries who derive income from farming 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 should contact their technical assistance liaison with the VCU NTDC for help!

Understanding Net Earnings from Self-Employment (NESE)

Before a CWIC can understand how self-employment income affects Social Security disability benefits, you must understand how Social Security views income generated from self-employment. For people who are self-employed, Social Security doesn’t count gross profits the business generated, but rather “net earnings from self-employment” (NESE). This is completely different from the way Social Security treats earned income from wage employment in which Social Security counts gross wages! The terms “gross” and “net,” and what they mean for someone who is self-employed and receiving Social Security disability benefits, can be confusing. 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 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 the gross sales minus any legitimate expenses that the business incurred. It’s this figure that a business owner reports to the IRS from which it assesses business taxes,
• Net Earnings from Self-Employment (NESE) is the net income or net profit from a business less half of the self-employment taxes the beneficiary pays. More detail on how NESE is derived is provided in the next section.

Turning Net Income into NESE

The difference between net income from a business and NESE is the deduction of the extra Social Security tax that self-employed people pay. For people in wage employment, employers pay half of the Social Security tax on an employee’s behalf, but self-employed individuals must pay the whole sum by themselves. When determining NESE, Social Security gives self-employed individuals credit for paying the employer’s 7.65 percent share of the Social Security and Medicare taxes in addition to the 7.65 percent share they would normally pay as an employee. When Social Security is trying to determine NESE for a current calendar year, it will take the estimated profit the beneficiary expects and will multiply that estimated net profit of the business by .9235. Social Security determines that factor by subtracting the percentage of extra taxes the beneficiary paid on each dollar of net earnings (.0765) from 1. When Social Security personnel are determining actual NESE for a calendar year that has concluded, they must perform the following steps:

• Add the gross earnings from all trades or businesses carried on by the self-employed person.
• Include the beneficiary’s distributive share of income from a partnership of which he or she is a general partner.
• Exclude any types of income so specified by the Act or the Internal Revenue Code (IRC).
• Subtract any ordinary and necessary expenses incurred in carrying on the business. In computing NESE, subtract from total receipts all of the business expenses, which are deductible under the IRC.
• Multiply the result by .9235 (i.e., 100% − 7.65% = 92.35% or 0.9235) to derive the NESE, beginning with taxable years after December 31, 1989.

Example of turning net income into NESE:

Jeanne estimates that she will have $2,000.00 in net profit. Jeanne operated her business beginning in November. Social Security 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.
Social Security only deducts the employer’s share of the self-employment tax to determine NESE when the beneficiary actually paid that tax. If the beneficiary paid no Social Security tax (either he or she didn’t owe any or because he or she didn’t file taxes), the deduction doesn’t apply. In addition, NESE may include in-kind income (e.g., food, clothing, shelter, a car, etc.). Social Security values in-kind income from NESE at its current market value.

Once Social Security determines the NESE for a given month, the agency uses that number as the starting point for SGA decisions and when determining how much SSI will be due. Social Security determines countable income by taking NESE and deducting any allowable work incentives. Social Security calculates NESE 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 his or her business, it’s called an “owner’s draw.” Owner’s draw isn’t a “salary” in the way this word usually applies but can include money, assets, or services the owner takes out of the business. A common misconception is that Social Security only counts what a beneficiary actually takes out of the business as earned income. Unfortunately, this isn’t true!

Remember that Social Security is interested in the “net earnings from self-employment” or NESE. 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 Social Security. Social Security uses NESE 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, Social Security refers to “owner’s draw” as “Withdrawals for Personal Use.” Because SSI is a means-tested program, if a beneficiary takes in-kind items or cash out of the business for personal use, Social Security could count it as income, which could cause a reduction in SSI cash payment, or possibly even cause ineligibility for SSI. When an individual alleges or when Social Security discovers that a beneficiary has withdrawn cash or in-kind items from a business for personal use, Social Security will ask the individual whether he or she properly accounted for the withdrawals in determining NESE. That is, did the beneficiary deduct them on his or her federal income tax return in determining the cost of goods sold or the cost of expenses incurred, or did he or she deduct them on his or her business records? If the individual alleges that he or she properly accounted for the funds, Social Security will accept this allegation and will NOT count this income against the individual again. If the individual did
NOT properly accounted for the withdrawals, Social Security will proceed in the following manner:

- Social Security will ask the individual to estimate the value of the cash or in-kind withdrawals. Social Security 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.
- If the individual can’t or won’t provide the profit and loss statement, but alleges an amount of NESE, Social Security will add the value of the withdrawals to the individual’s allegation of NESE.
- If an individual alleges withdrawals for personal use but can’t or won’t estimate the value of the withdrawals, or if the individual’s personal expenses exceed the stated NESE and no other income is available, Social Security 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 financial records, it’s against IRS rules for both small business and individual income reporting. No one should ever encourage beneficiaries to do this under any circumstances! Beneficiaries should deposit all income attributable to the business into the business account (not a personal bank account), and they must reflect this in the profit and loss statements for the business.

**Business Structures May Affect How Social Security Counts NESE**

Social Security treats different business structures in different ways when 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’s an important issue about which to counsel beneficiaries. The five types of business structures are summarized below:

1. **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 doesn’t even need a federal employer ID number, but can do business under the individual owner’s Social Security number.

2. **Partnership**: Partnerships exist 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.
3. **Limited Liability Company (LLC, PLLC):** An LLC is the newest form of business ownership. It’s 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 function like a sole proprietorship, partnership, or Sub S Corporation. Each state has certain requirements for setting up and maintaining an LLC.

4. **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. Businesses form a Sub S Corporation with the aid of an attorney or accountant.

5. **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, the IRS sees a C Corporation as a separate entity and taxes it 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. Businesses form a C Corporation with the aid of an attorney or accountant.

**Officers and Directors of Corporations**

Generally, Social Security considers an officer of a corporation to be an employee of the corporation. Social Security deems a corporate officer to be in “employment” even if he or she performs no services for the corporation, as long as he or she receives remuneration for holding corporate office. However, an officer of a corporation who as such doesn’t 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 Social Security doesn’t consider to be an employee of the corporation.

Although a corporate officer is generally an employee, payments made to the officer don’t constitute “wages” unless such payments are 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 aren’t 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 isn’t subject to control by the corporation. Therefore, a director who attends and participates in board meetings wouldn’t meet the common law test for an employee, but Social Security would deem the director 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, Social Security considers them to be employees. It’s good practice to check with the local Social Security 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 — particularly in the SSI program. For more information, refer to POMS RS 02101.016 Officer or Director of a Corporation, which can be found online here: https://secure.ssa.gov/apps10/poms.nsf/lnx/0302101016

A Warning about Businesses Structured as Corporations

Business structure does matter, and in most cases, forming a corporation isn’t the best way to proceed for a variety of reasons! Accountants who aren’t accustomed to working with beneficiaries of Social Security 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 that 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, people with liability claims against the can personally sue him or her — 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. Business owners can design LLCs 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! A full explanation of the various structures a business can take and how Social Security treats each structure would consume far more space than is available in this unit. In the overwhelming majority of cases, forming a corporation will most often be detrimental to a Social Security 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 that incorporation might provide. It’s critically important that beneficiaries meet with a certified CWIC experienced 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. These professionals should have some working knowledge of how self-employment affects beneficiaries of the Social Security 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 Social Security 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 Social Security treats NESE 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, because 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 track profits on a calendar-month basis! If month-by-month profit and loss statements are unavailable and the self-employed individual can’t recreate them, Social Security has no choice but to determine if the beneficiary used TWP months by dividing the NESE earnings for the particular work period by the months in which the beneficiary alleges he or she was engaged in self-employment. Averaging NESE in this manner, over a period of months may not always be in the best interests of the beneficiary and may cause the beneficiary to use more TWP months than he or she would if he or she used a month-by-month breakdown. Again, CWICs need to advise beneficiaries to track business income and expenses on a monthly basis to ensure that accurate Social Security makes accurate TWP determinations!

Even if the NESE for a calendar month is less than the current TWP guideline, the beneficiary may have to use a service month if he or she 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’s possible for a beneficiary to have NESE under the current TWP guideline and still use a service month. This isn’t the case in wage employment, and it represents a significant difference between how Social Security 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 Social Security to count that month toward the nine months of the TWP. Beneficiaries should keep track of the hours worked in the business. Hours that count are hours they spent on the ongoing business duties for pay or profit. The beneficiary shouldn’t count hours he or she spent simply planning the business.

**Special Work Incentives for Self-Employed Title II Beneficiaries**

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

**Unincurred Business Expenses**

In determining countable income from self-employment, Social Security deducts from the individual’s NESE any business expenses that the beneficiary incurred and that another person or agency paid for. Social Security makes this deduction even though the beneficiary incurred no actual expense. 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 unincurred 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, etc. Social Security 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 receives free help operating the business. Social Security can deduct the amount of wages the business would otherwise have paid the person if the business had to purchase the services.

**Example of how unpaid help affects NESE and SGA:** Lou is a lawyer who has just passed the bar. Her mother offers to help her in the office and drive her van to help her start her business. A neighbor offers to do some typing at no cost. Lou’s 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. Social Security 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, which Social Security may also deduct from her NESE.

Using the unpaid help and unincurred business expense deductions allows Social Security to adjust Lou’s self-employment income from $4,000.00 to countable income of $850.00. In 2015, the SGA guideline was $1,090 for individuals who aren’t blind. Because of subsidy for self-employed persons, Social Security would NOT consider Lou to be performing SGA.

When examining unincurred business expenses or unpaid help, it’s valuable to think through what the person needs, what the business has purchased, and what the beneficiary has received through family connections or services such as the State Vocational Rehabilitation agency (VR). It’s essential to keep records of any items or equipment provided to a business for both tax purposes and for SGA determination purposes, because reconstructing these deductions from memory may be difficult.

**How IRWEs Apply 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 that would qualify as IRWEs also meet the IRS definition of allowable business expenses. When this is the case, it’s much more advantageous for the beneficiary to deduct the expense when determining net profit since this decreases taxable income AND decreases the NESE for Social Security purposes. By running the expense through the business accounts, it also saves the beneficiary the time and effort of claiming an IRWE. It’s 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 Social Security 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 of business expense that is not an IRWE:** 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 she already used it to reduce her NESE.

CWICs should understand that there might be certain items that would meet the IRWE
requirements but may 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 Social Security does and doesn’t allow as a business expense. To learn more about
special tax rules for people with disabilities refer to IRS Publication 907 – Tax Highlights for

**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, Social Security uses a slightly different
form to collect information: Social Security 820 - Work Activity Report-Self-Employed. The
information Social Security seeks is also different because individuals who are self-employed
have more control of the income they report to the IRS than employees usually have. Second,
Social Security uses two different approaches when making SGA determinations for self-
employment beneficiaries — one approach for individuals who have been entitled to Social
Security disability benefits for 24 months or more and haven’t ceased, and a different approach
for individuals who have been entitled to benefits for less than 24 months or who have ceased.
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, Social Security will consider a
beneficiary 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 or she received Title II
disability benefits that he or she was due. The 24 months don’t have to be consecutive. For EXR
cases, the beneficiary will meet the 24-month requirement 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 didn’t actually receive a Title II disability cash benefit Social Security won’t count for the 24-month requirement.

When the countable income test applies, Social Security 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, Social Security will determine that the individual has engaged in SGA unless there is evidence that shows the individual didn’t 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 didn’t render significant services in the month(s), Social Security will generally determine that the individual hasn’t engaged in SGA.

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

Under some circumstances Social Security won’t use the countable income test, but rather will apply a more complex three-test approach to determine if an individual has engaged in SGA. Social Security 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 or she has received Title II disability benefits for at least 24 months is SGA;
- Determining whether work a beneficiary performed in or after the EPE or re-entitlement period is SGA after Social Security has determined an SGA cessation; and
- Determining SGA during the initial reinstatement period (IRP) for expedited reinstatement (EXR) cases.

The three tests are as follows:

1. 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. 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’s comparable to that of unimpaired individuals in the same community engaged in the same or similar businesses as their means of livelihood; or
3. 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 Social Security considers it in terms of its effect.
on the business, or when Social Security compares it to the salary an owner would pay to an employee for such duties in that business setting.

Social Security 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, Social Security will find a sole owner or partner to be rendering significant services if he or she:

- Contributes more than half the total time required for management of the business; or
- 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, Social Security will find the individual engaged in SGA if he or she receives a substantial income from the business. Social Security will determine a self-employed individual to have a substantial income from a business if:

- “Countable income” (NESE less any applicable work incentives) from the business averages more than the appropriate SGA Earnings Guideline, or
- “Countable income” (NESE less applicable work incentives) from the business doesn’t average more than the amount referred to above, but the livelihood that he or she derives from the business is:
  a. Comparable to that which he or she had before becoming seriously impaired, or
  b. 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” doesn’t exceed the applicable SGA guideline, Social Security 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 Social Security 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. Social Security personnel should include in their determination an account of all the factors they consider, so that it will be clear when Social Security isn’t to take an earnings report at face value. It’s especially important that Social Security give a detailed explanation 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 can’t derive the income ordinarily obtained from an enterprise of that type and scope.

Among relevant items Social Security should consider are 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.

When the business has been in existence for some time, Social Security personnel should obtain data regarding operations in the past (e.g., income tax returns) for the file. The impressions of the local Social Security 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 Social Security may now expect to yield considerably less income 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 or she became seriously impaired, and the individual continues to receive a comparable livelihood from it after becoming seriously impaired, Social Security will generally consider his or 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 Social Security can’t fairly consider his or her financial situation in that period 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 that don’t 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 isn’t controlling, Social Security should consider the commodities 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, Social Security excludes from consideration individuals who are, for various reasons, considered unrepresentative (e.g., where chronic illness accounts for a low level of income).

Social Security may question the self-employed beneficiary concerning the source and amount of his or her livelihood over a number of years (generally not less than five years) prior to becoming (or allegedly becoming) disabled. Where the individual doesn’t meet his or her personal standard of livelihood or the information he or she furnishes is inconclusive as to his or her personal standard of livelihood, Social Security 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, Social Security will need evidence from the local Chamber of Commerce or other informed sources.

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

If Social Security clearly establishes that the self-employed beneficiary isn’t engaging in SGA on the basis of significant services and substantial income under test one as described above, the agency will consider the second and third tests of the general evaluation criteria. Under these tests, Social Security will determine the individual to be engaged in SGA if evidence demonstrates that:

- 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;
- 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; or
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, Social Security may determine that the beneficiary is engaging in SGA. To establish comparability of work activity, Social Security 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 Social Security finding that the work performed isn't 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. Businesses must describe in detail each factor cited above, showing its contribution to the business operation. Social Security considers general descriptions as inconclusive evidence for the point-by-point comparison the evaluator is required to make. Social Security instructions clearly state that if only a general description is possible or available the agency should resolve any doubt as to the comparability of the factors 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, Social Security should obtain a description 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 the impaired person can provide. Social Security 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 might be evident in a poor farming area that management services on a small farm yielding a less-than-subsistence income wouldn't 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, Social Security should obtain evidence in appropriate detail and supplement it as required by opinions from authoritative sources in the community.
Examples of determining SGA for sole proprietors:

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 performs 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. Social Security determines that Fred’s work is comparable to SGA-level work. Social Security decides that Fred is performing SGA.

Test 3: In 2016, Octavia types and makes photocopies 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 $1,200.00 a month, instead of the $200.00 per month she reports. Octavia isn’t blind, and the applicable SGA guideline is $1,130.00. Social Security 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

Because 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 Social Security can readily compare to the SGA guidelines. Because of this variance, Social Security 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, Social Security generally averages income 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 just a few months. Social Security 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, Social Security considers each separately during an SGA determination. If Social Security finds any single endeavor to represent SGA, the agency decides the case on that basis. If no single work effort equals SGA, then Social Security combines the income from all work efforts. Any self-employment loss would never reduce total earnings. Social Security would simply represent the self-employment income as zero.

Final Words about Self-Employment and SGA Determinations

It’s much more likely that Social Security will make accurate and correct SGA determinations for self-employed beneficiaries if they keep complete accounting records. Benefit implications relate to the manner in which financial records are kept as well as the accuracy of month-by-month accounts. Because 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 Self-Employment

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

- How they determined his or her estimated NESE and its effect on eligibility or payment amount;
- To promptly contact the field office if any change occurs that could affect the amount of his or her estimated NESE;
- To maintain business records until a federal income tax return is available, so he or 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, Social Security generally bases the estimate on the individual’s allegation about what profits he or she expects to generate by the end of the calendar year. Depending on how much (or how little) the expected profit will be, Social Security 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, Social Security will obtain the individual’s profit and loss statement or other business records.
for his or her taxable year to date, will ascertain his or her net profit to date, and will project
that net profit for the entire taxable year to adjust the SSI cash payment moving forward. Social
Security personnel will NOT use this method of estimating NESE for businesses that are
seasonal or have unusual income peaks at certain times of the year. Social Security does this to
avoid underpayments caused by overestimating NESE and reducing the SSI cash payment too
much. After the initial year of business operations, Social Security 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 (12). It divides 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 Social Security
  computes net earnings as of the date of death); or
- The Commissioner of IRS closes the taxable year.

**NOTE:** An individual’s taxable year doesn’t end when the beneficiary goes out of business. Once
Social Security has determined how much NESE to attribute to each month in the calendar year,
it retroactively applies this income to determine how much in SSI cash payments were due.
Social Security will adjust the SSI check retroactively for the entire calendar year. In most cases,
if the business generated more profit than the beneficiary expected, it will mean that Social
Security overpaid the SSI recipient. After that first year of self-employment, Social Security 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 or her NESE for the current year will vary
from NESE for past years and gives a satisfactory explanation for the variation.

**Example of NESE for a self-employed beneficiary:** Martika is self-employed in a sole
proprietorship. Martika started her business in December 2015 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 2015, Social Security will consider Martika’s earnings to be $100.00 per
month throughout the 2015 calendar year.

**Example of NESE for a self-employed beneficiary:** Torrey operates a small business doing
interior design. He began his business in March and made a profit of $2,600 during the
first six 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, his NESE represented a loss of $200. Torrey submitted his tax returns to Social Security, and the agency did NOT reduce his SSI check for the past 12 months because he incurred a business loss. In the coming year, however, Torrey estimates his NESE to be $3,000. For the coming 12 months, Social Security will count an average of $250 in countable NESE. Torrey plans to watch his profits on a month-by-month basis and adjust his estimate of projected NESE if actual profits are significantly higher or lower than his projection.

If the business lost money in the calendar year as Social Security verifies by the tax returns, the agency divides any verified net loss for a taxable year evenly over the months in the taxable year. Social Security will subtract each monthly net loss amount from the individual’s other earned income (NESE or wages) in the same month, if any exists. Social Security doesn’t take into account an estimated net loss when estimating NESE for the current taxable year, because Social Security can only use a net loss to offset other earnings after Social Security has verified it. Social Security can only use verified losses 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 apply in wage employment and self-employment cases. The Student Earned Income Exclusion (SEIE) and Blind Work Expenses (BWE) apply 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 that would qualify as IRWEs also meet the IRS definition of allowable business expenses. When this is the case, it’s much more advantageous for the beneficiary to deduct the expense when determining net profit because this decreases taxable income AND decreases the NESE for Social Security purposes. By running the expense through the business account, it also saves the beneficiary the time and effort of claiming an IRWE. It’s 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, the beneficiary should deduct it 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 Social Security will assess eligibility for continued Medicaid under 1619(b). 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 Social Security can apply an individualized threshold amount.
- The individual must still be disabled per Social Security’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 aren’t accustomed to dealing with beneficiaries who are self-employed and often misapply the rules governing how Social Security determines NESE and applies it 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 and how much to report to Social Security. 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’s required that an SSI recipient inform Social Security when he or she is embarking on small business ownership in the initial months of self-employment, there really isn’t 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 beneficiary reports results on tax returns.

The best course of action is for the beneficiary to inform Social Security that he or she has started a small business as soon as operations begin. SSI recipients should initially provide a very conservative estimate of expected profits to Social Security. If they don’t expect profits, it’s imperative that they report this to Social Security 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 that isn’t offset by losses in previous months, the SSI recipient should report it to Social Security so that the agency can adjust SSI cash payments 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, Social Security uses projected estimates of annual NESE at the start of each calendar year to calculate the monthly SSI payment for the coming 12
months. Social Security bases this projection on the NESE the beneficiary earned for the prior year using completed tax returns and may adjust the projection based on what the beneficiary expects profits to be for the coming year. Providing Social Security 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 that he or she should reported to Social Security. 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, or cash in business accounts won’t cause ineligibility for SSI or Medicaid, but it all depends on how the owner structures the business. 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, Social Security specifically excludes assets held by the business as countable resources under a special provision called “Property Essential for Self-Support” or PESS.

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

- Property used in a trade or business (effective May 1, 1990);
- Property that represents government authority to engage in an income-producing activity;
- Property used by an individual as an employee for work (effective May 1, 1990); and
- Property required by an employer for work (before May 1, 1990).

The POMS citations describing application of PESS begin at the following URL:
[https://secure.ssa.gov/apps10/poms.nsf/517e83681a5eb8b28525688d0058721c/97b2eda9325340a78525754c00073830](https://secure.ssa.gov/apps10/poms.nsf/517e83681a5eb8b28525688d0058721c/97b2eda9325340a78525754c00073830)
Self-Employment and PASS

CWICs can assist beneficiaries pursuing a self-employment goal by developing a Plan to Achieve Self-Support (PASS). Because 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 that follows a very specific format. A copy of the business plan outline that Social Security 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

Social Security won’t deny a PASS because the business plan doesn’t 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 that 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. Social Security may allow costs associated with developing a business plan (if any) to 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 doesn’t preclude its use as a PASS expense during the calendar years (or fiscal years) that encompass the start-up period of a business.

Social Security gives a business a minimum start-up period of 18 months unless the individual indicates that he or she will need less time to sustain business operations. A business owner must justify a request for a start-up period of a longer duration than 18 months.
Self-Employment Combined with Wage Employment

Some beneficiaries participate in both wage employment and self-employment simultaneously. Social Security has very specific rules about how to count income 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. Beneficiaries can’t use losses from self-employment to offset SGA-level earnings in wage employment (See DI 10505.015 Averaging Countable Earnings).

In the SSI program, Social Security divides any verified net losses from self-employment over the taxable year in the same way as net earnings. The agency deducts the average monthly net loss only from other earned income of the individual or spouse in that month to determine gross income. It would then deduct work incentives from that amount when determining how much the Social Security 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 confuses CWICs 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. First, let’s start by explaining how CWICs 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 is 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; or
• 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’s much easier to advise beneficiaries who are in the very early stages of planning a business before they make missteps that 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 or 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; and
• Offering general advice on how self-employment income will affect disability benefits and how the beneficiary may use work incentives to finance a business start-up.

Some individuals who want to become self-employed don’t understand what this goal truly entails. Before the CWIC spends a great deal of time and energy connecting the beneficiary with sources of assistance for feasibility analysis and business plan development, it’s 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 for use in any initial discussion about self-employment. The handout (titled “So, You Want to be Self-Employed”) lists the major areas the beneficiary needs to consider before entering into self-employment and helps the CWIC determine how well the beneficiary has thought through the process, while highlighting the areas that need more work. CWICs should cover the following items in this conversation:

• Business feasibility;
• Capitalizing business start-up;
• Developing a written business plan;
• Business structure;
• Accounting and financial record keeping;
• Tax implications of self-employment;
• Licenses, permits or other legal requirements;
• Accommodations needed to operate the business successfully; and
• How self-employment will affect Social Security disability benefits and other public benefits.

Once the beneficiary has explored all of the areas listed above, the next step is 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, with which most CWICs have very little experience. The following chart provides some direction on activities within the business domain in which CWICs should participate as well as boundaries or limits CWICs have in this domain.

The Business Domain

CWICs should:

- Research local resources available to help beneficiaries with business planning, feasibility studies, financing, accounting systems and bookkeeping, tax planning/preparation, and setting up corporations/LLC, etc.
- Provide specific information and referral services to help beneficiaries connect with local sources of business expertise and assistance.
- Help beneficiaries understand the business plan requirements inherent in the PASS program — reviewing business plans and providing general feedback about whether or not they meet PASS requirements.
- Advise beneficiaries about the impact of various business structures (corporations, LLC, sole proprietorship, etc.) on public benefits.
- Advise beneficiaries on the impact of accounting methods (accrual vs. cash) on public benefits.
- Help beneficiaries understand how to include work incentive payments in their business financial statements.

CWICs should NOT:

- Help beneficiaries decide what type of business they should pursue.
- Determine whether or not a beneficiary is capable of starting and managing a business.
- Provide direct assistance with writing, editing, or critiquing business plans.
- Share information with beneficiaries on any legal or tax issues related to business establishment or management. Give advice to beneficiaries on sources of business financing beyond work incentives related to public benefits. CWICs don’t assist with preparing financing requests or loan applications.
- Perform feasibility studies or assessments. CWICs aren’t qualified to evaluate the viability of a business concept.
- Prepare financial statements for the business such as break-even analysis, cash flow analysis, or income/expense statements.
- Provide business analysis, consultation, and problem solving services to increase profitability.
The following is an explanation of the CWIC’s role in some of the most common areas related to the business domain:

**The Business Concept and Business Feasibility**

It’s 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 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’s NOT the CWIC’s job to tell a beneficiary that a business concept is unrealistic, unfeasible, etc.
- It’s the CWIC’s job to know when a business concept may need more refinement or research before the beneficiary can write a business plan or before successful start-up is likely.
- It’s 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 or 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’s important for CWICs to explain to beneficiaries preparing for self-employment that business structure does have an impact on how Social Security will treat the NESE and also how it may affect resource determinations for SSI recipients. If the beneficiary hasn’t yet determined what business structure is best, the CWIC should provide advisement on how Social Security treats different types of structures and how the various structures may impact that individual’s benefits. Many accountants will recommend incorporation, because this is often most advantageous for individuals who aren’t on disability benefits. CWICs need to warn beneficiaries about this possibility and should be specific about why this course of action wouldn’t 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 Social Security 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 beneficiary has already established a business structure by the time he or she makes contact with the CWIC, you will need to discuss how Social Security will treat income from the business based on chosen business structure, and identify potential options for changing business structure, if warranted. Once a business is operational, an owner can change the business structure, although it may cause some inconvenience and incur expense.

**Business Plan Development**

Determine whether or not a formal written business plan is necessary. In most cases, it will be, but in some cases, it won’t. 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 the beneficiary is pursuing a PASS;
- If the State VR Agency or EN is providing funding for the business;
- If the beneficiary is seeking a business loan; or
- If other funding sources require it.

If the beneficiary does need to develop a business plan, 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 the business planning process. They should also review general information about how Social Security treats self-employment earnings.

**What CWICs Need to Know about Business Financials**

It’s 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 his or her 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.) is listed across the 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 P&Ls and how to account for work incentives such as:
Don’t include in P&L statements any PASS expenses that are also IRS allowable business expenses. Exclude from the P&L any PASS expenses that would NOT meet IRS rules for business expenses. Do NOT list PASS income in the P&L, as it’s not a form of income, but rather the “owner’s investment.” For tax purposes, Social Security would consider the income that beneficiaries use to fund a PASS 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.

Don’t include in the P&L statements any IRWEs/BWEs that are also IRS allowable business expenses. CWICs should note that beneficiaries can’t claim IRWEs/BWEs included as business expenses when reducing countable NESE during SGA determinations or when Social Security is adjusting the SSI check. That is because Social Security has already accounted for the expenses when determining the amount of profit. To claim these expenses a second time would constitute “double dipping,” and Social Security doesn’t permit it.

Beneficiaries should NOT include in the P&L statements any expense purchased by other sources (VR, WIA, etc.). However, if the business owner directly receives funds from other sources (VR, WIA, etc.), both the funds and the expenses are included in the P&L.

NOTE: Under certain circumstances the beneficiary may exclude from income reported to the IRS, any items or cash the beneficiary received to pay for rehabilitation needs. 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 don’t 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. Keep the following parameters in mind when counseling self-employed beneficiaries:

CWICs aren’t accountants. Don’t advise beneficiaries on specific accounting techniques or strategies.

CWICs may be called upon to advise accountants or bookkeepers about various things including:
a. Recordkeeping for Social Security
b. Impact of self-employment income on benefits
c. Impact of accounting on work incentives usage or vice versa
d. Business structures (many accountants recommend incorporation for tax reasons, which may be disadvantageous to the beneficiary)

Some accountants do have knowledge of Social Security benefits. When that is the case, the CWIC should be ready to provide resources or referral information as necessary.

CWICs should inform self-employed beneficiaries of all information that they should gathered and retain. Most of the information Social Security needs is the same information the IRS requires. Social Security (or 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 Social Security cash benefits and Medicaid/Medicare, as well as other federal, state, and local benefits. There is no difference between wage employment and self-employment in terms of the CWIC’s benefits counseling and work incentives advisement responsibility.

CWICs should:

- Explain the effects of self-employment income and business ownership on SSI, Social Security disability benefits, Medicaid, Medicare, and all other public assistance programs.
- Prepare a detailed, written Benefits Summary & Analysis to spell out how self-employment will impact benefits.
- Provide specific advice about use of work incentives in self-employment, based upon the unique needs of the individual.
- Teach beneficiaries how they may use work incentives to help fund self-employment.
- Provide specific advice about, and assistance with the use of a PASS in establishing a business.
- Facilitate the development of a PASS to include coordinating with Social Security PASS specialists to facilitate approval of the plan.
- Act as an intermediary with business advisors to help them understand how Social Security may apply work incentives to help establish a business.
- Act as an intermediary with accounting or bookkeeping professionals to help them understand specific accounting needs related to Social Security benefits.
Follow up periodically with beneficiaries pursuing self-employment with active PASSes to see that everything is going as planned.

CWICs should NOT:

- Attempt to talk beneficiaries out of pursuing self-employment due to the complex inter-relationship between business ownership and public benefits.
- Simply refer the beneficiary to local SBDC or SBA without fulfilling the responsibility for assisting with the Benefits Summary & Analysis.
- 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.
- 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.
- Take responsibility for setting up business accounts, reporting estimated earnings to Social Security, or keeping track of PASS expenditures. The CWIC’s role is to teach the beneficiary to do these things.
- Provide WIPA services to individuals who are withholding information about income and resources from Social Security or misrepresenting net earnings from self-employment to any agency administering public benefits programs.

**Reporting Self-Employment Income to Social Security**

CWICs should invest time and energy into teaching self-employed beneficiaries what income they need to be report to Social Security 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 can make problems for themselves by not keeping their books on a regular basis and not preparing their taxes in a timely fashion. Remember, it’s NESE that Social Security cares about, not gross income or even gross profit from the tax returns, and certainly NOT “owner’s draw.” Social Security may further reduce countable NESE by applying work incentives. 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 that CWICs should share with beneficiaries.

**Reporting Tips for Title II Disability Beneficiaries**

- 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 statements will work for this reporting.

- Beneficiaries should track all hours spent operating the business on a calendar month basis. Beneficiaries must be aware that they may be using TWP months even if the business loses money if they spend more than 80 hours running or working in the business in a calendar month.

- 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’s advisable to submit the profit and loss statements to Social Security and request that the agency conduct a work CDR. If the beneficiary waits until the tax year ends before reporting profits to Social Security, it’s possible that a large overpayment could occur. Even if the business loses money, it’s essential that the beneficiary gets his or her taxes prepared promptly and submitted to Social Security for review.

- NEVER report gross sales or gross receipts from the business to Social Security! 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. Beneficiaries should also submit completed tax returns to Social Security each year as soon as they prepare them.

### Reporting Tips for SSI Recipients

- SSI recipients are required to notify Social Security when they initiate self-employment, even if they don’t generate profits.
- Because Social Security may adjust the SSI payment by estimated profits in the initial year of business operations, it’s essential to supply an accurate initial estimate to Social Security. Recipients should be conservative in their estimate to avoid Social Security reducing the cash payment reduced too much. Recipients should carefully monitor profits on a month-to-month basis and adjust the estimate based upon actual countable NESE that they produce.
- After the initial year of operations, watch out for using projected NESE! Social Security 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.
- When the beneficiary uses estimates to adjust the SSI cash payment, he or she must diligently and carefully track actual NESE and adjust the projections quarterly as needed.

### Common Mistakes CWICs Make in Reporting NESE
• GROSS income isn’t what Social Security counts — it’s countable NESE. Beneficiaries should never report gross income to Social Security when they are self-employed.

• Social Security doesn’t count PASS funds as income to the business. The agency counts them as owner investment and aren’t reportable to the IRS as part of the business tax returns.

• Neither Social Security nor the IRS permits beneficiaries to claim personal expenses as business expenses. The beneficiary must have a legitimate business purpose for the beneficiary to deduct the expense legally. When in doubt, beneficiaries should get the advice of a qualified tax professional.

• Mixing business and personal funds is a VERY common problem for self-employed beneficiaries. They must keep funds separate to meet both Social Security and IRS requirements.

Final Words on Supporting Beneficiaries to Achieve Self-Employment Goals

There are some significant differences in the way that Social Security 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, CWICs can’t avoid them, and you must pursue them with the same diligence as wage employment cases. The intent of this unit is 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. Undoubtedly, there will be cases that require additional research and extended support from the VCU National Training Center personnel. CWICs should seek such support whenever questions arise.

Conducting Independent Research

POMS References:

DI 10510.000 - Evaluation and Development of Self-Employment
DI 10510.001 - SGA Evaluation and Development of Self-Employment
DI 10510.010 - SGA Criteria in Self-Employment
DI 10510.012 - Determining Countable Income
DI 10510.015 - Test One of General Evaluation Criteria: Significant Services and Substantial Income
DI 10510.020 - Tests Two and Three of General Evaluation Criteria: Comparability of Work and Worth of Work Test
DI 10510.025 - Documenting Self-Employment Cases
DI 10510.030 - Completion of SSA-820-F4 (Work Activity Report — Self-Employed Person)
DI 10510.035 - SSA-820-F4 Identification Items
DI 10510.040 - SSA-820-F4 — Work Activity Report — Self Employed Person
SI 00820.200 - Net Earnings from Self-Employment (NESE)
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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