Self-Employment and Supplemental Security Income (SSI)

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Understanding Net Earnings from Self Employment (NESE)

Before a CWIC can understand how self-employment income affects Supplemental Security Income (SSI) 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:

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

Example of turning net income into NESE:
Jeanne estimates that she will have $1,000 in net profit per month.

To determine Jeanne's estimated NESE for those months, multiply $1,000 by .9235.

$1000 × .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.

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:

1. 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.
2. 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.
3. 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.

NESE and SSI

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 Net Earnings from Self Employment (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. Social Security personnel 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 2021 and made $1,200 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 2020, Social Security will consider Martika's earnings to be $100 per month throughout the 2020 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 ($3,000 divided by 12). 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 countable 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 sometimes 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 POMS online (https://secure.ssa.gov/apps10/poms.nsf/lnx/0501130500).

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 (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. 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 - https://secure.ssa.gov/apps10/poms.nsf/lnx/0500820210).

Resources

- SI 00820.200 Net Earnings from Self-Employment (NESE) (https://secure.ssa.gov/apps10/poms.nsf/lnx/0500820200)
- SI 00820.210 How to Determine Net Earnings from Self-Employment (NESE) (https://secure.ssa.gov/apps10/poms.nsf/lnx/0500820210)

- SI 00820.220 How to Verify Net Earnings from Self-Employment (NESE) (https://secure.ssa.gov/apps10/poms.nsf/lnx/0500820220)
- SI 00820.230 How to Estimate NESE for Current Taxable Year (https://secure.ssa.gov/apps10/poms.nsf/lnx/0500820230)

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