

STATE OF TENNESSEE
DEPARTMENT OF HUMAN SERVICES
NASHVILLE, TENNESSEE

MEMORANDUM

MA-03-02

TO: ALL DISTRICT AND COUNTY OFFICES

FROM: MARY ANNE RUDOLPH, DIRECTOR, MEDICAID/TENNCARE POLICY

DATE: FEBRUARY 21, 2003

SUBJECT: TREATMENT OF INCOME RECEIVED FROM SELF-EMPLOYMENT

This memorandum clarifies the treatment of income received from self-employment for the purposes of Medicaid and TennCare eligibility. Use the previous year's federal income tax return to verify income from self-employment.

Self-employment Income

Self-employed individuals report their Net Earnings from Self-employment (NESE) on their federal income tax returns. NESE is the gross income from any trade or business less allowable deductions for that trade or business. NESE also includes any profit or loss in a partnership. For the purposes of determining financial eligibility for Medicaid and TennCare, we count the NESE on a taxable year basis and divide the total of these earnings equally among the months in the taxable year to get the earnings for each month. For example, if your net earnings for a taxable year are \$2,400, we consider that you received \$200 in each month.

When to Verify NESE:

Verify NESE whenever self-employment is alleged or otherwise indicated, unless the individual:

- Alleges starting a new business, and that he/she was not self-employed in the prior taxable year; or
- He/she has applied for or is receiving Title II (Social Security) benefits.

How to Verify NESE:

Using the federal income tax return, verification of NESE is found on the following schedule:

1. Schedule SE (Self-employment)

The self-employed and certain church employees use schedule SE (self-employment) to compute their Net Earnings (or loss) from SE for Social Security tax purposes.

- Net earnings – Section A, line 4 or Section B, line 4.c.
If line 4 or 4.c. shows a positive amount of less than \$400, then line 3 is used. Even if the amount on line 3 is greater than \$400. For example: line 3 shows \$410 and line 4 or 4.c shows \$378; line 4.c. should be used because no tax was due.

NOTE: Other Schedules (C, C-EZ, F, etc.) can be reviewed to see the net profit or loss for the business but are only used to determine what business is being reported as self-employment.

Depreciation

In computing NESE, a deduction may be taken for a reasonable allowance for depreciation; i.e., the decrease in value of an item of property through wear, deterioration or obsolescence. Accept the amount of depreciation shown on a tax form, unless an item of depreciation raises a question of propriety.

Example: A minister deducts as an expense his ordinary and necessary expenses such as investments, stationary, stenographic help and travel expense. In the year 2001, he purchased new Bibles and Hymnals. Since books and equipment have a useful life of more than one year, they are considered capital assets. The entire cost may be not deducted in the year of purchase, but the cost could be recovered in the following years through depreciation.

Partnership

Any distributive share (whether distributed or not) of income or loss from a trade or business carried on by a partnership is included in NESE, unless specifically excluded.

- The guaranteed salary is allowed as a business deduction in computing partnership income.
- The receiving partner is not considered an employee of the partnership.
- Guaranteed salary payments are not “wages” but NESE.

Count the NESE when determining income derived from self-employment.

Capital Gains

Money received from Capital Gains or Losses from the sale of capital assets is not income.

Example: Mr. Smith’s business is farming. Mr. Smith owns 4 farms and reports all income received from his farming enterprise on his federal income tax return filed in 2001. Mr. Smith sold one of his farms for \$100,000 in May 2002. The money received from the sale of his farm is not considered as income when determining eligibility for Medicaid **or** TennCare Standard.

For purposes of Medicaid, the money he received from the sale of his farm is counted as a resource. It is considered a conversion of a resource (the exchange of an excluded resource for a countable resource).

For purposes of TennCare Standard, Capital Gains are excluded because resources are not considered for applicant/recipients of TCS.

When Mr. Smith files his federal income tax return for 2002, IRS will compute his taxes based on his income and his capital gains and losses. In determining his income for Medicaid/TennCare, only consider the NESE and divide it by 12 to arrive at a monthly figure.

Schedule D (Capital Gains and Losses) used to report both short-term and long-term capital gains and losses from partnerships, Subchapter “S” corporations and fiduciaries.

Schedule E (Supplemental Income and Losses) used to report both short-term and long term capital gains and losses from partnerships, Subchapter “S” corporations.

Schedule F (Farm Income and Expenses) used to report income and expenses from a farm operation.

Schedule K1 (Form 1065) Partner's Share of Income, Credits, Deduction, etc. used by a member of a partnership, joint venture, or a shareholder in a Subchapter "S" corporation to recapitulate the income or loss allotted by the business to that individual. This amount is then shown on that individual's SE. This form is not filed with the tax return because the business enterprise has filed an information return showing the amount allotted to each member.

Form 1065 (U.S. Partnership Return of Income) is used by the partnership to report income and deductions.

Form 1120 (U.S. Corporation Short-form Income Tax Return) is used generally by corporations that have gross receipts, total income, or total assets under \$500,000 to report profit and loss.

If the applicant/recipient cannot provide an income tax return, you may accept:

1. Business Records

- When business records are used to arrive at the NESE, use the individual's gross income and allow the applicant/recipient the same deductions that are allowed by IRS to determine the NESE. (This includes any business-related expenses, including depreciation.)

Please use business records when a federal income tax return is not available, or the individual has made changes, stopped or added to the business.

2. Individual's Signed Allegation

- If acceptable evidence of NESE cannot be obtained any other way, you may accept the applicant/recipient's signed allegation.

Consider all factors in the case when an individual alleges participating in an activity that produces income to determine if it constitutes self-employment.

Please remember to use the NESE from the correct schedule in determining income for self-employment. **IRS has already deducted any business-related expenses including depreciation.** If the applicant/recipient cannot provide an income tax return but is using business records and claims depreciation as a business deduction, please remember depreciation is an allowable deduction for Medicaid and TennCare.

ACCENT Procedures

Because depreciation is an allowable deduction for Medicaid/TennCare and it is not an allowable deduction for Food Stamps or Families First, please use the following procedure when an individual reports income from self-employment.

- For individuals applying for Medicaid/TennCare and Food Stamps: Please enter depreciation expenses on AEISE, but use code ES (employer FICA share) under type because ES is an allowable deduction for Medicaid/TennCare, but is not an allowable deduction for FS. This should ensure the budget is correct for both programs without having to fiat the case.
- For individuals applying for Families First and TCS, where income of an individual must be counted in both Aid Groups, you will need to contact the ACCENT help desk.

Any questions concerning this memorandum should be directed through the Medicaid Policy Unit.

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