



# **U.S. Department of Housing and Urban Development Office of Housing Counseling Understanding Self-Employment for Income Verification**

**March 24, 2015**

**12:00 PM**

Facilitated by

**Booth Management Consulting, LLC**

7230 Lee Deforest Drive, Suite 202, Columbia, MD 21046

FACILITATED BY:  
Robin Booth, CPA

**BMIC**  
BOOTH MANAGEMENT CONSULTING, LLC

# Training Topics

- Definitions and Terminology
- Self-Employed vs. Employee
- Computing Self-Employed Income
- Questions



# DEFINITIONS AND TERMINOLOGY



# Definitions and Terminology

- Self-Employed (Independent Contractor)
- Employee
- Income
- Expense
- Costs of Goods Sold/Sales
- Net Income/Loss
- Profit and Loss Statement and Balance Sheet
- Adjustments and Add Back
- Relevant Tax Forms

# Definitions

## Self-Employed (Independent Contractor)

Source	Definition
<b>Webster's Dictionary</b>	Earning income from your own business or profession rather than by working for someone else
<b>Internal Revenue Service Website</b>	A business owner or contractor who provides services to other businesses
<b>Revenue Ruling 58-112</b>	A trade or business activity as one that is regular, frequent and continuous and make ongoing efforts to further the interests of the business.

# Definitions and Terminology

## Employee

Source	Definition
Webster's Dictionary	A person who works for another person or for a company for wages or a salary
Internal Revenue Service Website	Anyone who performs services for another person or a company <b>and if they do not control what will be done and how it will be done.</b>

**Statutory Employee** – Meet common law IRS rules as self-employed but are still considered employees includes drivers paid on commission or as agent, salesperson, etc.

# Definitions and Terminology

## Income

Term	Definition
<b>Gross Income</b>	Compensation for services performed and/or goods purchased before any deductions.
<b>Taxable Income</b>	The income that is subject to taxation. Taxable income remains after accounting for adjustments and deductions.
<b>Self- Employed Income</b>	Taxable income of a person involved in a sole proprietorship or other sort of free-lance work



# Definitions and Terminology

## Expenses

Source/Type	Definition
<b>Accounting</b>	Money spent or cost incurred in an entity's efforts to generate revenue.
<b>IRS Website</b>	Cost of carrying on a trade or business usually deductible if the business operates to make a profit.
<b>Capital Expense</b>	<p>Capitalize, rather than deduct, costs that are a part of investment in the business and are considered assets in the business. In general, there are three types of costs you capitalize.</p> <ul style="list-style-type: none"><li>• Business start-up cost (See the note below)</li><li>• Business assets</li><li>• Improvements</li></ul>

# Definitions and Terminology

## Costs of Goods Sold

Cost of Goods Sold, or COGS, is also called cost of sales (COS) or cost of revenue. COGS is the category of expenses directly related to producing a product or service. It includes all the costs directly involved in producing a product or delivering a service. These costs can include labor, material, and shipping. The idea behind COGS is to measure all the costs directly associated with making the product or delivering the service.

# Definitions and Terminology

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# Definitions and Terminology

## Net Income/Loss

Type	Definition
<b>Net Income</b>	Profits or net earnings of a company determined by gross income less deductible expenses and depreciation.
<b>Net Earnings</b>	Certain income is not considered in net earnings for income tax purposes including dividend income, interest from loans, income from a limited partnership.
<b>Eligible Self-Employed Net Income</b>	Self-employed net income used to determine program eligibility based on the program requirements for income and deductible expenses.

# Definitions and Terminology

## Profit and Loss Statement/Balance Sheet

Term	Definition
<b>Profit and Loss Statement</b>	A financial statement that summarizes the revenues, costs and expenses incurred during a specific period of time - usually a fiscal quarter or year. Prepared on a cash or accrual basis
<b>Balance Sheet</b>	A statement of the assets, liabilities, and capital of a business or other organization at a particular point in time, detailing the balance of income and expenditure over the preceding period. Prepared on a cash or accrual basis.

# Definitions and Terminology

## Adjustments and Add Backs

Most closely held businesses are run by their owners to minimize taxable income. To determine the actual profitability of such businesses, the financial statements need to be adjusted. Typical adjustments or add-backs to the Profit and Loss Statement include:

- Owner's compensation and benefits in excess of market.
- Depreciation and amortization.
- Interest expense.
- Extraordinary or one-time expense items.
- Items identified in a grant/contract

# Definitions and Terminology

## Relevant Tax Forms

Type	Definition
<b>IRS Form 1099-MISC</b>	Year-end summary of all non-employee compensation for self-employment and independent contractor income.
<b>IRS Form Schedule C, Profit or Loss from Business</b>	Profit or loss as a sole proprietorship. Included with an individual's personal income tax return.
<b>IRS Form 1065, U.S. Return of Partnership Income</b>	Profit and loss for a partnership (2 or more individuals). Individuals should receive a Form K1 to be included in their return.
<b>IRS Form 1120 S, U.S. Income Tax Return for an S Corporation</b>	Profit and loss for a corporation. Individuals should receive a Form K1 to be included on their return.

Why emphasize this?



# SELF-EMPLOYED VS. EMPLOYEE





# Self-Employed vs. Employee

## The IRS says:

- If you are a business owner hiring or contracting with other individuals to provide services, you must determine whether the individuals providing services are employees or independent contractors.
- Determined on a case-by-case basis.

# Self-Employed vs. Employee

Self-Employment – IRS Common Law Rules

## Behavioral

Does the company control or have the right to control what the worker does and how the worker does his or her job?



## Financial

Business aspects of the worker's job controlled by the payer

## Relationship

Written contracts or employee type benefits

# Self-Employed vs. Employee

Questions To Ask?



## Self Employed, Yes or No?

1. Separate Taxpayer Identification Number? ✓
2. Tax forms filed as business? ✓
3. Receive no benefits (health insurance, etc.) from client? ✓
4. Bill the client? ✓
5. Deductible expenses? ✓
6. Status determinations from IRS or state tax agency? ✓

# Self-Employed vs. Employee

## Self-Employed Yes or No?

- Example 1: The client is a housekeeper, she cleans several people's homes several times a week. For the most part, she has her own equipment and supplies (i.e. vacuum, dusters, cleaning products, etc.); however on occasion some of the home owners provide their own supplies that they would rather be used to clean their home. The decision on what days to perform the cleaning and how much to charge for the services is an agreement between the home owners and the housekeeper. The client can choose which homes to clean and whether or not to negotiate on the amount to get paid for the services provided. In this situation the client is self-employed. ✓ Yes
- Example 2: The client is a housekeeper who is employed by the company Merry Maids. the company decides which homes the client will provide housekeeping services for, how much to charge for the service and the company pays the client for those services. In this situation the client is not self-employed, since an employee-employer relationship exists between the client and Merry Maids. ✗ No



# COMPUTING SELF-EMPLOYMENT INCOME



# Computation of Self-Employed Income

Two Approaches: Method #1

**Gross Income**

-

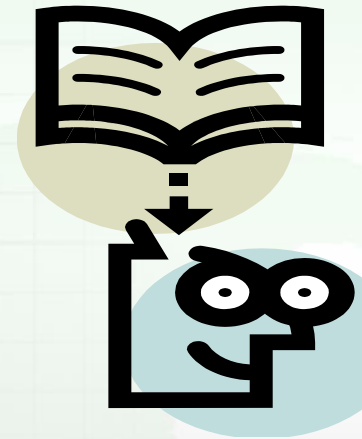
**Deductible Expenses**

+/-

**Adjustments and Add Backs**

=

**Eligible Self-Employed Income**



# Computation of Self-Employed Income

Method #2

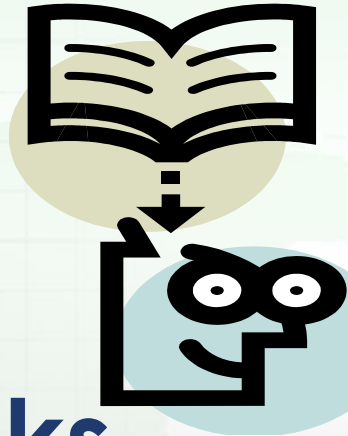
**Net Profit/Loss**

**+/-**

**Adjustments and Add Backs**

**=**

**Eligible Self-Employed Income**



# Computing Self-Employed Income

Example:

Organization's self-employed income computation requirements:

1. Deduct: out-of-pocket business expenses such as office rent, telephone, etc., which are generally tax-deductible items.
2. Include: all entertainment and travel expenses, private retirement contribution plans, advertising, and property or equipment depreciation (which may be tax-deductible but are not allowable deductions when calculating eligibility income).



# Computing Self-Employed Income

	Gross Income	\$	1,000,000	100%
<b>Less</b>	Cost of Goods Sold	\$	426,200	42.6%
	Gross Profit	\$	573,800	57.4%
<b>Less</b>	Expenses			
	Accounting and legal fees	\$	11,700	
	Advertising	\$	15,000	
	Depreciation	\$	38,000	
	Electricity	\$	2,700	
	Insurance	\$	15,200	
	Interest and bank charges	\$	27,300	
	Postage	\$	1,500	
	Printing and stationery	\$	8,700	
	Professional memberships	\$	1,800	
	Rent for premises	\$	74,300	
	Repairs and maintenance	\$	21,100	
	Training	\$	6,900	
	Vehicle operating costs	\$	20,000	
	Wages and salaries	\$	223,500	
	Workers compensation	\$	6,500	
	All other expenses	\$	14,100	
<b>Less</b>	Total Expenses	\$	488,300	48.8%
<b>Equals</b>	Net Profit (BOS)	\$	85,500	8.6%

# Computing Self-Employed Income

## Computation of Self-Employed Income

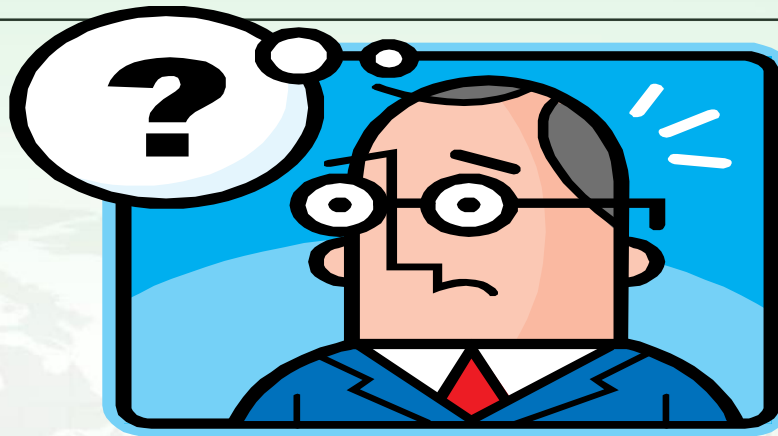
### Method #1

Gross Income			1,000,000
Less: Deductible Expenses			
Costs of Goods Sold	(426,200)		
Expenses	(488,300)		
Subtotal	(914,500)		(914,500)
Add: Adjustments/Add Backs			
Depreciation	38,000		
Advertising	15,000		
Subtotal	53,000		53,000
Eligible Self-Employed Income		\$	138,500

### Method #2

Net Profit/Loss			85,500
Add: Adjustments/Add Backs			
Depreciation	38,000		
Advertising	15,000		
Subtotal	53,000		53,000
Eligible Self-Employed Income		\$	138,500





## Questions

Please forward any questions to

[housing.counseling@hud.gov](mailto:housing.counseling@hud.gov) with

Understanding Self-Employment

in Subject line

**THANK  
YOU**