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Self-Employment Activity – Averaging Income from Self-Employment Activity (IC-CO-04-01)

Child Support Guidelines, N.D. Admin. Code §§ -02-04.1-05(4)

Question: When an obligor engages in a self-employment activity, how should the income from that activity be averaged if a loss was incurred in at least one of the years in the period being averaged?

Answer: A loss from a self-employment activity incurred in a year that is included in the period being averaged is to be factored into the calculation to determine the average self-employment income. This can be illustrated by the following example:

Obligor has operated a self-employment activity on a substantially similar scale for a five-year period and has no other income. The income (or loss) from the activity during the five-year period is:

Year 1	Year 2	Year 3	Year 4	Year 5
-$2,000	$25,000	$30,000	-$4,000	$20,000

Obligor's average self-employment income for the five-year period is $13,800 ($75,000 - $6,000 = $69,000; $69,000 5 = $13,800).

By way of background, North Dakota's child support guidelines recognize that self-employment activities can experience significant changes in income and production over time. Accordingly, N.D. Admin. Code 75-02-04.1-05(4) provides that to the extent information is reasonably available, "the average of the most recent five years of each self-employment activity, if undertaken on a substantially similar scale, must be used to determine self-employment income." This subsection also provides that when self-employment activity has not been operated on a substantially similar scale for five years, a shorter period may be used.

Child Support Division had received anecdotal information indicating that a variety of methods were being used to determine average self-employment income in cases where a self-employment activity resulted in a loss for at least one of the years in the period being averaged. Under one such method, any loss years were included in determining average self-employment income over a five-year period (or over a shorter period, if applicable). Essentially, under this method, the loss years offset the gain years for the period being averaged.

Under another method, loss years were not factored into the determination of average self-employment income. Essentially, under this method, a loss was treated as zero. Under yet another method, a minimum wage income was imputed to the obligor for any loss year included in the period being averaged.

The appropriate treatment for loss years in the context of determining average self-employment income is not explicitly expressed in the guidelines. However, the language therein implies that such loss years are to be factored into the determination, provided the self-employment activity is operated on a substantially similar scale over time. In general, an "average" indicates a middle position on a scale of evaluation or a midpoint between extremes. In other words, determining average self-employment income is a way to "even out" significant fluctuations in income and production of the self-employment activity over time. This is best accomplished by including the loss years in determining average self-employment income such that the loss years offset the gain years in the period being averaged. Ignoring the loss years in the determination (either by treating the loss as zero or by imputing income in place of the loss) defeats the purpose of averaging in these situations.

Reference: Minutes of the Department of Human Services Child Support Guidelines Drafting Advisory Committee, June 6, 2002.

Inquiries to: Child Support
PO Box 7190
Bismarck, ND 58507-7190
Phone: 701-328-5440