INCOME

UNEARNED INCOME

H. RENTAL INCOME

Rent is a payment which an individual receives for the use of real or personal property, such as land, housing or machinery.

Net rental income is gross rent less the ordinary and necessary expenses paid in the same taxable year.

Ordinary and necessary expenses are those necessary for the production or collection of rental income. In general, these expenses include:

- interest on debts;
- State and local taxes on real and personal property and on motor fuel;
- general sales taxes; and
- expenses of managing or maintaining property.

See below for a more specific list.

To determine if rental property can be excluded as a resource, refer to the Resources section for a discussion of Income-Producing Property.

1. Policy Principles

The following policy principles apply to rental income:

- Depreciation or depletion of property is not a deductible expense.
- Deduct expenses when paid, not when incurred.
- Net rental income is unearned income unless it is earned income from self-employment (e.g., someone who is the business of renting properties).
- Rental deposits are not income to the landlord while subject to return to the tenant. Rental deposits used to pay rental expenses become income to the landlord at the point of use.
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- In determining net rental income, do not consider rents received or expenses paid in months prior to Medicaid eligibility.

- In determining net rental income, consider rents received or expenses paid in a month in which the case is ineligible as if the case had been eligible (interim months of ineligibility).

2. Deductible Expenses

Examples of deductible expenses:

- interest and escrow portions of a mortgage payment (at the point the payment is made to the mortgage holder);

- real estate insurance;

- repairs (i.e., minor correction to an existing structure);

- property taxes;

- lawn care;

- snow removal; and

- advertising for tenants.

3. Nondeductible Expenses

Examples of nondeductible expenses:

- principal portion of a mortgage payment; and

- capital expenditures (i.e., an expense for an addition or increase in the value of property which is subject to depreciation for income tax purposes).

If uncertain whether an expense is allowable (e.g., whether it is an incidental repair or a capital expenditure), contact the local Internal Revenue Service (IRS) or refer to IRS Publication 527. Document the file with the information obtained from IRS.
4. **Multiple Family Residence**
   - In multiple family residences:
     - If the units in the building are of approximately equal size, prorate allowable expenses based on the number of units designated for rent compared to the total number of units.
     - If the units are not of approximately equal size, prorate allowable expenses based on the number of rooms in the rental units compared to the total number of rooms in the building. (The rooms do not have to be occupied.)

5. **Rooms in Single Residence**
   For rooms in a single residence:
   a. Prorate allowable expenses based on the number of rooms designated for rent compared to the number of rooms in the house.
   b. Do not count bathrooms as rooms in the house.
   c. Count basements and attics only if they have been converted to living spaces (e.g., recreation rooms).

6. **Land**
   We prorate expenses based on the percentage of total acres that is for rent.

7. **Determining Net Rental Income**
   a. Determine gross rent received and deductible expenses month-by-month.
   b. Subtract deductible expenses paid in a month from gross rent received in the same month.
   c. If deductible expenses exceed gross rent in a month, subtract the excess expenses from the next month's gross rent and continue doing this as necessary until the end of the tax year in which the expenses is paid.
d. If there are **still excess expenses** after applying b. above, subtract them from the gross rent received in the month prior to the month the expenses were paid and continue doing this as necessary to the beginning of the tax year involved.

**NOTE:** Do not carry excess expenses over to other tax years nor use them to offset other income.

**Example:**

An individual receives $100 gross rental income monthly. He pays allowable expenses of $200 in July and $400 in November. His taxable year is January 1 through December 31. The allocation is as follows:

The $200 allowable expenses paid in July reduce the net rental income to zero in July (the month the expenses were paid) and August (the subsequent month). The $400 allowable expenses paid in November reduce the net rental income to zero in November (the month paid); December (the subsequent month); October (the month preceding the month the expenses were paid); and September (the next preceding month).

**Note:** Allowable expenses must be timely submitted in order for the expense to be considered as a deduction from rental income. This is true since policy specifies to begin the deduction in the month in which the expense is paid. For each month the expense is not submitted after payment of the expense, the deduction for that month is lost (although any excess may be allowed in a subsequent month or a month prior to payment if an excess exists at the end of the tax year).
8. Verification of Rental Income

To verify rental income, request the individual's Federal income tax return (including Schedule E) for the most recent closed tax year, and retain a copy for the file. This will be helpful in identifying the most usual expenses deducted from rental income in the past, and as an aid in estimating rental income for the future. Regardless of whether the most recent tax return is available, also request other records (bills, receipts, etc.) to establish actual gross rental income and allowable expenses for the period involved.

Verification of the amount of rental income and dates received, and of the amount of allowable expenses and dates paid, must be documented in the file. Therefore, place in the file copies of all records (bills, receipts, etc.) use in computing the amount of net rental income. If the individual has no tax return or other records, obtain the individual's signed statement explaining why no records are available and providing his/her allegation of the amount of gross rental income and allowable expenses for the period involved.

Use an individuals' amortization schedule to determine interest expense. If a schedule is not available, divide the yearly interest by twelve to determine monthly interest.
9. **Joint Ownership Rental Income**

If an eligible individual and eligible spouse (couple) jointly own rental property, it is not necessary to compute each person's share of the rental income in cases where income must be combined for the couple. In all other joint ownership cases, including those where a third person owns rental property with an eligible couple, it is necessary to determine what share of the rental income (after deduction of allowable expenses, if any) is charged to the eligible. Absent evidence to the contrary, apportion the net rental income equally among the owners. However, if the joint ownership agreement or other evidence (e.g., tax return, statements of joint owners) shows some other distribution, consider that evidence in determining the eligible's share of net rental income. In situations where there is evidence of other than equal apportioning, document the file with a copy of any evidence obtained, the decision reached, and the reason for the decision as to how income is apportioned.

10. **Estimating Future Rental Income**

When projecting future rental income, use the documentation obtained from the prior tax year, as outlined in "Verification of Rental Income," to estimate anticipated income and expenses for the current tax year. For future periods, deduct only those expenses which are predictable; i.e., those which recur regularly and the amount of which can be estimated with a reasonable degree of accuracy. Examples of such predictable expenses include interest payments, property taxes, insurance premiums and utilities. Do not project variable (unpredictable) expenses. Consider variable expenses after they have been paid, when the payment can be documented. Examples of variable expenses include repairs and advertising costs.