200.07.17 RENTAL INCOME

Rent is payment that a person receives for the use of real or personal property, such as land, housing or machinery. Net rental income is gross less the ordinary and necessary expenses paid in the same taxable year. In determining Medicaid eligibility for at-home and institutional categories, consider net rental income.

Deductible Expenses

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 tax;
- Expenses of managing or maintaining the property.

Specific examples of deductible expenses include:

- 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 corrections to the existing structure;
- Property taxes;
- Lawn care;
- Snow removal;
- Advertising for tenants;
- Utilities.

Nondeductible Expenses

The following are not allowable expenses:

- Principle portion of a mortgage payment;
- Capital expenditures, i.e., an expense for an addition or increase in value of the property which is subject to depreciation for tax purposes (For example, a new roof or replacement of the central heating and air unit.)
- Depreciation or depletion of property.

NOTE: If uncertain about whether an expense is allowable, e.g., whether it is an incidental repair or a capital expenditure, refer to IRS Publication 527 or contact the local Internal Revenue Service (IRS).

Treatment of Rental Income

- Expenses are deducted when paid, not when incurred.

- Net rental income is counted as unearned income unless it is earned income from self-employment (such as someone in the business of renting properties).

- Rental deposits are not counted as income to the landlord, while subject to return to the tenant. However, rental deposits used to pay rental expenses do become income to the landlord at point of use.

- In determining net rental income, do not consider rents received or expenses paid in months prior to Medicaid eligibility.

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

- For 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 approximately equal size, prorate allowable expenses based on the number of rooms in the rental units compared with the total number of occupied or unoccupied rooms in the building.

  - Any expenses strictly related to a particular rental unit are deducted in total from rent for that unit and not prorated.

- For rooms in a single family residence:

  - Prorate allowable expenses based on the number of rooms designated for rent compared to the number of rooms in the house, excluding bathrooms and counting basements or attics only if they have been converted to living spaces, e.g. recreation rooms).

RENTAL INCOME (Continued)

  - Any expenses strictly related to a particular rental room are deducted in total from rent for that room and not prorated.

- For land, prorate based on the percentage of total acres for rent.
- For joint ownership, apportion the income equally among the owners unless a distribution other than equal apportioning is verified. Apportioning is not necessary in cases where the income is combined for the couple who jointly own rental property.

Determining Net Rental Income

- **Determine** gross rent received and deductible expenses month by month.
- **Subtract** deductible expenses paid in a month from gross rent received in that same month.
- If deductible expenses exceed gross rent in a month, subtract **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 expense is paid.
- If there are **still excess expenses** , 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.
- **Do not** carry excess expenses over to other tax years and do not 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 rent to zero in July (the month the expenses were paid) and in August (the subsequent month). The $400 allowable expenses paid in November, reduce the net rentall income to zero in November (the month paid), December (the subsequent month), October (the preceding month) and September (the next preceding month).

RENTAL INCOME (Continued)

Timely Submission of Allowable Expenses

Allowable expenses must be submitted timely in order for the expense to be considered as a deduction from rental income. The 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 is lost; although any excess may be allowed in a subsequent month or month prior to payment if an excess exists at the end of the tax year.

Verification of 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 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 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 the dates paid must be documented in the file. Copies of all record (bills, receipts, etc.) used in computing the amount of net rental income must be in the file. If the individual has no tax return or other records, obtain the individual's signed statement of the reason no records are available and providing his allegation of gross rental income and allowable expenses for the period involved.

Use an individual's amortization schedule to determine interest expense. If a schedule is not available, divide the yearly interest by twelve to determine monthly interest.

Estimating Future Rental Income

When projecting future rental income, use the documentation obtained from the prior year as discussed above 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 can be estimated with a reasonable degree of accuracy. Examples of predictable expenses include interest payments, property taxes, insurance premiums and utilities. Do not project variable or unpredictable expenses. Consider variable expenses after they have been paid when payment can be documented. Examples of variable expenses include repairs and advertising costs.