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12 RENT DEPOSIT ISSUES

By Victor Sy, CPA, MBA

Security deposits are a leading cause of conflict between landlords and tenants. So how can one avoid such disputes? Let's identify, define, and discuss advance rent, security deposit, and other issues:

1. **Advance rent** is income regardless of the period covered. Advance rent for the last month is income in the year received. Most property owners are on cash basis (report income in the year received, regardless of when you earn it).
2. **Security deposit** is not income if you plan to return it at the end of the lease. Whatever you keep because tenant did not fix up the unit at the end of lease becomes income. Tip: Be consistent.
3. Payment received from a tenant to **cancel lease** is income. Payment received under a lease with option to buy is rental income. If tenant exercises option, any payment after sale becomes part of selling price.
4. **Cleaning**: Define the clean-up required with a simple checklist to prevent disagreements later. Take photos before and after to help define the level at move-in.
5. **Restoring to original condition**: Condition when the unit is first rented is easily agreed upon at the start of the lease but becomes a pain at termination of the lease. Take photos or videos before and after.
6. **Damage**: Injury to the premises (broken window, damaged stove) is paid from security deposits.
7. **Excessive wear & tear**: Conduct an inventory with photographic backup.
8. **Missing items**: Fixture cannot be removed without written permission from the landlord.
9. **Breaking a Lease**: Work out a solution (replacement tenant) with the manager or landlord. If you are a co-lessee and decide to leave, you will need to share with the rent until another person replaces your spot.
10. **Notice to terminate rent**: Most states require a tenant to give written notice of 10 - 30 days.
11. **Deduction Warning**: A written warning is now required in California and other states. Get forms from AAGLA (Apartment Association of Greater Los Angeles) or FAA (Foothill Apartment Association).
12. **If tenant pays an expense and offsets the amount from rent**, include the amount as both income and expense. For example, if a tenant paints your property in exchange for a full month rent of \$1,200, report that \$1200 as income and deduct the same \$1,200 as expense. (TIP: Adding the \$1,200 to income will help you sell the rental at a higher price when gross multiplier is used to estimate market value).