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## RENTAL INCOME

By Victor Sy, CPA, MBA

**Rental Income:** Rental income is any payment you receive for the use of property. It includes amounts or services received for the occupancy of your duplex, 4-unit apartment, or commercial property.

**When To Report:** Report income in the year you receive it, regardless of when it was earned. Since most owners use the cash basis of accounting (report it when you receive it), we will use this method of accounting for the rest of this discussion.

**Advance Rent:** Include advance rent in your rental income in the year you receive it regardless of the period covered or the method of accounting used. For example, you receive in 2008 \$1,000 for the first month (January 2008) and another \$1,000 for the last month (December 2010) of a three-year lease. Both amounts should be reported in 2008, even if the last month's rent applies to 2009. This is an application of the cash method of accounting – report the income when you receive it.

**Security Deposits:** Do not include security deposit in your income when you receive it if you plan to return it to your tenant at the end of the lease. But if you keep part or all of the security deposit during any year because your tenant does not live up to the terms of the lease, include the amount you keep in your income in that year. If part of a security deposit is to be used as a final payment of rent, it is an advance rent and should be included as income when you receive it, as discussed above.

**Uncollected rent.** If you are a cash basis taxpayer as most of you are, you do not report uncollected rent. I have seen taxpayers deduct uncollected rent as bad debt. Don't do it. It's an audit red flag. The logic is rather simple. You can't deduct as bad debts an item that you never reported as income. If you use the accrual method of accounting, report uncollected rent as income and if you are not to collect, deduct that as bad debt.

**Expenses Paid By Tenants:** Expenses paid by tenants are treated as rental income. You should also deduct the equivalent expense. For example, a tenant calls and directly pays a plumber to repair a faucet leak for \$4,000, I mean \$400. At the end of the month, the tenant deducts that amount from a monthly rent of \$1,000 and remits only \$600. Include \$1,000 as rental income. Deduct \$400 for repairs.

**Services Received In Exchange For Rent:** Include the fair rental value of services you receive as rental income. Of course, you can also take the expenses as deduction. For example, one of your tenants is a painter. The tenant volunteers to paint a recently vacated unit for \$1,000. Instead of paying you \$1,000 for rent, he calls it even. You must include that \$1,000 fair market value as rental income and \$1,000 as painting expense.

**Payments To Cancel Or Modify Lease:** If your tenant pays you to cancel or modify a lease, the amount you receive is rental income. Include the payment as gross rent in the year you receive it regardless of your method of accounting.

**Lease With Option To Buy.** If the rental agreement gives your tenant the right to buy your rental property at a later date, payments you receive before the purchase are generally rental income. If your tenant exercises the right to buy the property, payments you receive after the date of sale are considered part of the sales price.