Trainer Manual

Module 5

Part A: Trainer Instructions and Lesson Plans

OVERVIEW OF MODULE 5

- ***Introduction.*** Module 5 is perhaps the most challenging of the six RHIIP training modules. Module 5 expands the concept of assets and asset income into the areas of real estate and trusts. In addition, module 5 introduces the concept of business income, business expenses and inclusion of business income in annual income. Module 5 also revisits the issue of assets disposed of for less than fair market value, as well as addressing exclusions from income based on the Earned Income Tax Credit (EITC).
- ***Specific Objectives of Module*** 5 are to enable participants to:
  - Identify the various elements of business income and business expenses, as well as net business income
  - Calculate business income to be included in annual income
  - Determine the value of real estate as an asset, including the value of real estate sold by a family member through a mortgage or deed of trust
  - Calculate the income to be included in annual income related to the real estate
  - Understand the principles of trusts, as well as the distinctions between revocable and nonrevocable trusts
  - Determine whether the value of a trust should be included as a family asset and what income from the trust should be included in annual income
  - Recognize assets disposed of for less than fair market value and how such assets are counted in net family assets
  - Understand earned income tax credits (an exclusion from annual income) and recognize the ways in which a family may be receiving such tax credits
- ***Training Objectives*** of Module 5 include giving participants the opportunity to practice applying their understanding of business income, real estate and trusts to specific real-world situations and families. Through the case studies, the trainer seeks to help participants apply the rules on income and assets to families and circumstances that are more complex, requiring the participant to interpret information and documentation, and to use their understanding of the rules to make informed judgments and decisions.

ORGANIZATION OF MODULE 5

- ***Part I: Business Income and Business Assets*** addresses the issue of businesses owned by family members, calculation and documentation of gross business income and eligible deductions (including business loans) to establish net business income, as well as amounts to be included in the family's annual income.
- ***Case study 1*** offers an example of a family-owned business and leads the participant step-by-step through a determination of business income.
- ***Part II: Real Estat***e discusses situations where a family member may own real estate, including determination real estate as an asset, calculation of equity in the real estate and the actual family income derived from the real estate.
- ***Case study 2*** offers a scenario whereby a family member co-owns real estate with others outside the family, and provides the opportunity to calculate both the value of the asset and also the income to be derived from the asset.
- ***Part III: Trusts as Assets*** offers a discussion of trusts, both as assets available to the family and as income to the family.
- ***Part IV: Assets Disposed of for Less than Fair Market Value*** revisits the discussion introduced in Module 4 on the value of assets disposed of by the family and how such assets are counted in net family assets.
- ***Case studies 3A and 3B*** illustrate the principles of trusts as assets, using examples of both revocable and nonrevocable trusts, as well as assets disposed of for less than fair market value.
- ***Part V: Other Income and Asset Issues*** addresses two additional issues not covered elsewhere in the modules – mortgages and deeds of trust as assets to the family, and the earned income tax credit as an exclusion from the family's annual income.
- ***Case studies 4A, 4B and 4C*** encompass many of the issues discussed throughout Module 5. Two additional exercises are offered for business income. Exercises are also included for practice in recognizing and addressing the earned income tax credit received by a family member.

- ***Self Study Tests.*** The module includes pre- and post-training tests that are intended to be for the participant's use to identify areas that require additional study. In addition to providing the correct answer, the explanations contained in the answers provide further elaborations of requirements.
  - In a classroom setting these test questions should be used as additional exercises.
  - Self study learners should review the explanations carefully.
  - The tests should not be used as the basis for certification or as part of a performance evaluation process. They do not provide enough questions to make a valid assessment for either of those purposes.
  - Answers to the tests are provided in the attachments at the end of the module.
- ***Trainer Notes.*** Specific instructions for discussing the material are provided immediately before each training block, as well as in the notes sections of the materials. Instructions for presenting the case study, if needed, are found on the page before the Case Study.
- ***Introduction to Multifamily Housing Case Studies Training***
  - An introduction to the entire training program is found on pages i through iv of the Participant Manual and pages T-i through T-x of the Trainer Manual.
  - If Module 5 is presented at the same time as the other modules in the training series, it is not necessary to give an overview of the entire training program before each module. But if Module 5 is used as a stand-alone presentation, an introduction to the entire case studies training series would be appropriate.

LESSON PLAN AND AGENDA: CONFERENCE CALL

- The lesson plan and agenda shown below are for a three-hour conference call. The plan makes the following assumptions:
  - In order to successfully cover the material contained in Module 5 in three hours, participants must complete in advance: the pre-training self test, review of the materials and the four case studies.
  - Approximately 15 minutes of the call will be set-aside for questions from participants.
  - The post-training self test is an important part of Module 5, but it is not intended to be covered in the conference call itself. It is shown on the plan as an activity to be completed after self-study of the Module 5 materials, or after the conference call.
- A sample agenda for this conference call is found at the beginning of the Module 5 Participant Manual, on the page entitled “Agenda.”

Sample Lesson Plan
Module 5 - Three Hour Conference Call

Module 5 Objectives

- At the end of this module, participants will be able to:
  - Identify the various elements of business income and business expenses, as well as net business income
  - Calculate business income to be included in annual income
  - Determine the value of real estate as an asset, including the value of real estate sold by a family member through a mortgage or deed of trust
  - Calculate the income to be included in annual income related to the real estate
  - Understand the principles of trusts, as well as the distinctions between revocable and nonrevocable trusts
  - Determine whether the value of a trust should be included as a family asset and what income from the trust should be included in annual income
  - Recognize assets disposed of for less than fair market value and how such assets are counted in net family assets
  - Understand earned income tax credits (an exclusion from annual income) and recognize the ways in which a family may be receiving such tax credits

Pre-Call Participant Preparation

- Complete the pre-training self test, review Module 4, complete case studies 1-4
- Estimated level of effort: 3 hours (learner with experience); 4-5 hours (new learner)

Methods, Timeframes and Materials

- Of necessity, the training method on a conference call is primarily lecture. A participant question and answer period will be provided at the end of the conference call.
- The chart below summarizes the timeframes and materials for each segment of the conference call.

Module 5 - Conference Call Content Timeframes and Materials	
Topic	**Timeframes and Materials**
Introductions and Overview • Introduce call facilitators • Module 5 Introduction • Review agenda for the call	Timeframe: 15 minutes Manual: pages 5-1 through 5-8 Self test answers in Participant Manual, Attachment A, pages 5-107 through 5-109
Part I Summary Discussion • Part I: Business Income and Business Assets • Review Case Study 1	Timeframe: 45 minutes Manual: pages 5-9 through 5-38 Case Study 1 Answers in Participant Manual Attachment B, pages 5-110 through 5-120
Part II Summary Discussion • Part II: Real Estate • Review Case Study 2	Timeframe: 45 minutes Manual: pages 5-39 through 5-64 Case Study 2 Answers in Participant Manual Attachment C, pages 5-121 through 5-131
Parts III and IV Summary Discussion • Part III: Trusts as Assets • Part IV: Assets Disposed of for Less than Fair Market Value • Review Case Studies 3A and 3B	Timeframe: 30 minutes Manual: pages 5-65 through 5-90 Case Study 3 Answers in Participant Manual Attachment D, pages 5-132 through 5-143
Part V Summary Discussion • Part V: Other Income and Asset Issues • Review Case Studies 4A, 4B and 4C	Timeframe: 30 minutes Manual: pages 5-91 through 5-98 Case Study 4 Answers in Participant Manual Attachment E, pages 5-144 through 5-149
Question and Answer Session	Timeframe: 15 minutes Manual: None
Post-training Self Test • Participants may use this tool after studying Module 5 or after the conference call	Timeframe:15 minutes Manual: pages 5-99 through 5-104 Self test answers in Participant Manual, Attachment F, pages 5-150 through 5-155

LESSON PLAN AND AGENDA: CLASSROOM TRAINING

- The lesson plan and agenda shown below are for a one-day (6 hour) classroom training program on Module 5.
- A full day may be required to train Module 5 topics in detail with a new learner group, but a full day may not be required for more experienced learners.
- Especially if participants must travel a significant distance to attend the training, you may wish to consider asking new learners to study the material in advance and then cover two modules in a single day.

Sample Lesson Plan
Module 5 - Classroom Training

Module 5 Objectives

- At the end of this module, participants will be able to:
  - Identify the various elements of business income and business expenses, as well as net business income
  - Calculate business income to be included in annual income
  - Determine the value of real estate as an asset, including the value of real estate sold by a family member through a mortgage or deed of trust
  - Calculate the income to be included in annual income related to the real estate
  - Understand the principles of trusts, as well as the distinctions between revocable and nonrevocable trusts
  - Determine whether the value of a trust should be included as a family asset and what income from the trust should be included in annual income
  - Recognize assets disposed of for less than fair market value and how such assets are counted in net family assets
  - Understand earned income tax credits (an exclusion from annual income) and recognize the ways in which a family may be receiving such tax credits

Methods, Timeframes and Materials

- The format is intended to be an interactive discussion.
  - Participants generally are not expected to complete the Pre-training Self Test before the day of the session. The test may be administered as part of the formal session and/or participants may be encouraged to take the test during the registration process.
  - Participants will complete the case studies during the session.
  - Participants should complete the Post-training Self Test as part of the session.

- The chart below summarizes the timeframes and materials for each segment of the training. The chart includes references to Power Point slides that have been prepared for use in the classroom.
- A sample agenda is provided following the chart.

Module 5 - Classroom Training Content Timeframes and Materials	
Pre-training Self Test (Participants may be asked to complete the self study test before the session begins as part of the registration process or as part of the introduction, as shown below.)	
Topic	**Timeframes and Materials**
Introductions and Overview • Format: Presentation and Information Collection • Introduction of trainer(s) and participants • Introduction to Module 5 • Review agenda for the training • Administer Pre-training Self Test	Timeframe: 15 minutes without self test; 30 minutes with self test Manual: pages 5-1 through 5-8 Power Points: 1-24 Self test answers in Participant Manual, Attachment A, pages 5-107 through 5-109
Part I • Format: Presentation and Interactive Discussion • Business Income and Business Assets • Case Study 1	Timeframe: 2 hours Manual: pages 5-9 through 5-38 Power Points: 25-96 Case Study 1 Answers in Participant Manual Attachment B, pages 5-110 through 5-120
Part II • Format: Presentation and Interactive Discussion • Real Estate • Case Study 2	Timeframe: 1 hour, 30 minutes Manual: pages 5-39 through 5-64 Power Points: 97-142 Case Study 2 Answers in Participant Manual Attachment C, pages 5-121 through 5-131

Module 5 - Classroom Training Content Timeframes and Materials	
Parts III and IV • Format: Presentation and Interactive Discussion • Trusts as Assets • Assets Disposed of for Less than Fair Market Value • Case Studies 3A and 3B	Timeframe: 1 hour Manual: pages 5-65 through 5-90 Power Points:143-198 Case Study 3 Answers in Participant Manual Attachment D, pages 5-132 through 5-143
Part V • Format: Presentation and Interactive Discussion • Other Income and Asset Issues • Case Studies 4A, 4B, and 4C	Timeframe: 1 hour Manual: pages 5-91 through 5-98 Power Points: 199-224 Case Study 4 Answers in Participant Manual Attachment E, pages 5-144 through 5-149
Post-training Self Test	Timeframe: 15 minutes Manual: pages 5-99 through 5-104 Power Points: None Self test answers in Participant Manual, Attachment F, pages 5-150 through 5-155

Sample Agenda
Multifamily Housing Case Studies Training Program
Module 5 Classroom Training

8:00 – 8:30	**Registration**
8:30 – 9:00	**Introductions** • Overview of the Training • Pre training Self Test
9:00 – 10:30	**Business Income and Business Assets** • Gross Business Income and Net Business Income • Business Expenses • Business Loans • Business Income as Annual Income
10:30 – 10:45	**Break**
10:45 – 11:15	**Business Income and Business Assets (cont)** **Case Study 1**
11:15 – 12:00	**Real Estate** • Real Estate as an Asset • Determining Equity in Real Property • Income from Real Estate
12:00 – 1:00	**Lunch**
1:00 – 1:45	**Real Estate (cont)** **Case Study 2**
1:45 - 2:45	**Trusts as Assets** • Definition of a Trust • Revocable vs. Nonrevocable • Assets Disposed of for Less than Fair Market Value **Case Study 3**
2:45 – 3:00	**Break**
3:00 – 4:00	**Other Income and Asset Issues** • Mortgage or Deed of Trust • Earned Income Tax Credit (EITC) **Case Study 4**
4:00	**Post training Self Test**

Trainer Manual

Module 5

Part B: Annotated Participant Manual

Trainer Notes

- The agenda on the following page is the agenda for a conference call format. See Part A for an agenda for classroom training.
- The agenda is followed by a table of contents for Module 5 that begins the specific introduction to Module 5. The table of contents is a reference tool for participants and does not need to be discussed.
- The appropriate place to discuss the organization of Module 5 is on page 5-2.

RHIIP HELP DESK CONFERENCE CALL
MODULE 5
February 23, 2005

AGENDA

Time: 1:00 PM to 4:00 PM EST

Chairperson: Cynthia Thomas, HUD

Facilitators: Cynthia Thomas, HUD
Nan McKay, Nan McKay and Associates

Confirmation Number: 36416958
Dial In Number: 1-800-347-3350

Pre-conference Participant Responsibilities

- Complete the pre-training self test and review answers
- Review training manual
- Complete Case Studies 1 – 4

1:00 – 1:15 Introductions and Overview

1:15 – 2:00 Business Income and Business Assets

- Case Study 1: The Curly Q Salon

2:00 – 2:45 Real Estate

- Case Study 2: The Barkers

2:45 – 3:15 Trusts as Assets
Assets Disposed of for Less than Fair Market Value

- Case Study 3A: A Generous Grandmother
- Case Study 3B: A Cautious Arrangement

3:15 – 3:45 Other Income and Asset Issues

- Case Study 4A: The Curly-Q Salon—Under New Management
- Case Study 4B: A Clean Business
- Case Study 4C: Earned Income Tax Credit (EITC)

3:45 – 4:00 Questions and Answers

Post-Training Participant Responsibilities

- Complete Post-Training Self Test
- Complete Training Evaluation

NOTES

INTRODUCTION TO MODULE 5

OVERVIEW

- Module 5 is the fifth in a series of six training modules developed in support of the Rental Housing Integrity Improvement Project (RHIIP).
- Like Modules 1, 2 and 4, this module uses HUD Handbook ***4350.3 REV-1, Occupancy Requirements for Subsidized Multifamily Housing*** as the primary source document. The module includes brief topic discussions based on Handbook 4350.3 REV-1 and several case studies that are designed to give the learner practice in applying HUD policies.
- Module 5 continues the discussion of assets begun in Module 4, focusing on two of the more complex asset and income issues: *real estate* owned by family members, and *trusts* as assets. Module 5 also revisits the issue of assets disposed of for less than fair market value, with additional examples and exercises.
- Module 5 addresses the challenging areas of *self-employment* and *businesses* owned by family members, the income generated by businesses and how business income is calculated for purposes of annual income. Module 5 also includes a discussion of the earned income tax credit exclusion from income, with case study examples.
- Principles of income and rent calculation discussed in earlier modules are reinforced throughout Module 5, with case studies and examples affording participants the opportunity to continue to practice and apply their understanding.
- As with prior modules, Module 5 may be used as a self-study tool or in a formal training program.

OBJECTIVES

- At the end of this module, participants will be able to:
  - Identify the various elements of business income and business expenses, as well as net business income
  - Calculate business income to be included in annual income
  - Determine the value of real estate as an asset, including the value of real estate sold by a family member through a mortgage or deed of trust
  - Calculate the income to be included in annual income related to the real estate
  - Understand the principles of trusts, as well as the distinctions between revocable and nonrevocable trusts
  - Determine whether the value of a trust should be included as a family asset and what income from the trust should be included in annual income
  - Recognize assets disposed of for less than fair market value and how such assets are counted in net family assets
  - Understand earned income tax credits (an exclusion from annual income) and recognize the ways in which a family may be receiving such tax credits

ORGANIZATION OF MODULE 5

- ***Part I: Business Income and Business Assets*** addresses the issue of businesses owned by family members, calculation and documentation of gross business income and eligible deductions (including business loans) to establish net business income, as well as amounts to be included in the family's annual income.

- ***Case study 1*** offers an example of a family-owned business and leads the participant step-by-step through a determination of business income.

- ***Part II: Real Estate*** discusses situations where a family member may own real estate, including determination real estate as an asset, calculation of equity in the real estate and the actual family income derived from the real estate.

- ***Case study 2*** offers a scenario whereby a family member co-owns real estate with others outside the family, and provides the opportunity to calculate both the value of the asset and also the income to be derived from the asset.

- ***Part III: Trusts as Assets*** offers a discussion of trusts, both as assets available to the family and as income to the family.

- ***Part IV: Assets Disposed of for Less than Fair Market Value*** revisits the discussion introduced in Module 4 on the value of assets disposed of by the family and how such assets are counted in net family assets.
- ***Case studies 3A and 3B*** illustrate the principles of trusts as assets, using examples of both revocable and nonrevocable trusts, as well as assets disposed of for less than fair market value.
- ***Part V: Other Income and Asset Issues*** addresses two additional issues not covered elsewhere in the modules – mortgages and deeds of trust as assets to the family, and the earned income tax credit as an exclusion from the family's annual income.
- ***Case studies 4A, 4B and 4C*** encompass many of the issues discussed throughout Module 5. Two additional exercises are offered for business income. Exercises are also included for practice in recognizing and addressing the earned income tax credit received by a family member.

MODULE 5 – PRE-TRAINING SELF TEST

- Note: This test is provided as a learning tool for participants. The pre-training self test is designed to measure your level of knowledge before you study this module. Answer the questions as best you can (without looking at the training materials or Handbook 4350.3 REV-1). A post-test is available at the end of the module to measure how much you have learned.

Answers to Pre-training Self Test are in Attachment A at the end of this module.

1. The creator of a trust always has access to trust funds, but the beneficiary of a trust only has access to revocable trust funds.
   a. True
   b. False

2. Business loans represent a debt for the business. In paying off this debt, an individual's regular payment will include an amount that is applied to the principal portion of the debt and an amount designated to pay the interest owed on the debt. For purposes of calculating net business income, the entire amount of the individual's regular loan payment is used as a business expense.
   a. True
   b. False

3. Equity in real property is known as the property's:
   a. Conversion value
   b. Principal value
   c. Cash value
   d. Market value

4. For purposes of calculating net business income to include in annual income, net business income equals gross business income minus what three (3) amounts?

   Net business income equals gross business income minus:

5. To calculate a property's cash value, take the property's current market value and subtract what two (2) amounts?

   Cash value equals current market value minus:

6. An asset that is placed in a nonrevocable trust by a family member would be considered an asset disposed of for less than fair market value.
   a. True
   b. False

7. When a family member's main occupation is buying, selling or renting real estate, then any real estate owned by the family member and used in the business is not counted as an asset to the family.
   a. True
   b. False

8. Earned income tax credit (EITC) payments received as a lump sum refund payment are not counted as annual income. However, EITC payments received periodically as regular advance payments must be counted in annual income.
   a. True
   b. False

9. Carlos, a handyman, has just completed painting an apartment for a customer. He is paid $800 for the job. For this particular job, Carlos spent $150 for supplies and paid his assistant $200. What is Carlos's gross income and net income for this job?

Gross income =	
Net Income =	

10. In order to encourage self-sufficiency and investment in real estate, if a family member's net income from their property is a negative amount, this amount is used to offset other family member income.
    a. True
    b. False

Trainer Notes: Approach to Case Study 1 and Presentation Materials

Purpose

- Case Study 1 is designed to help learners understand the intricacies of anticipating net income from a business.
- The written materials in Part I summarize Handbook 4350.3 REV-1 requirements related to self-employment and tenant-owned businesses. Taken together with the case study, the materials also supplement 4350.3 REV-1 with additional information on some of the principles of business income and expenses.

Materials

- The Part I materials discuss the following key concepts related to business income:
  - Counting the net (rather than gross) income
  - Treatment of salaries and other compensation to family members
  - The treatment of business assets, including depreciation
  - Eligible business expenses
- The case study provides financial information about the Curly-Q Salon, a tenant-owned business. The ultimate goal of the case study is to determine the income from the business that should be included in the family's annual income. To accomplish this the case study requires participants to:
  - Reconcile the prior year's income and expenses as shown on the financial statement and IRS 1040 Schedule C
  - Determine the principal and interest to be paid on a business loan during the coming recertification period using a loan amortization schedule
  - Compare prior year income expenses to partial current year expenses to anticipate future income and expenses
- Answers to the case study are found on page 5-110 in the Participant Manual.

Presentation vs. Review

- In a conference call format, participants are expected to have completed the case study in advance.
- In a classroom training setting, Part I should be presented as an interactive discussion and participants should complete the case study in class.

Tips and Cautions

- The determination of business income is one of the most challenging rent calculation tasks because of the variety of business encountered. In addition, family businesses are infrequently encountered in assisted housing, leading to basic unfamiliarity with the principles and concepts. Trainers should be well versed in the concepts explained in the manual and in Handbook 4350.3 REV-1 and should expect that participants will raise questions about additional types of businesses.
- Since detailed training on this topic is rare, sufficient time should be allowed to enable the trainer to walk through the manual in detail. Numerous examples are provided in the manual before the case study. Each should be reviewed in detail.
- Participants are likely to have the most difficulty with two topics: (1) the treatment of loans and (2) depreciation of assets.
- Case Study 1 requires in-depth analysis of detailed financial information. Although the instructions lead participants through the necessary analysis trainers should stop at key points to confirm that most participants are on the right track to avoid frustration and confusion. The following flow is recommended.
  - Review the background information with participants and identify each of the four documents provided and their purpose. Instruct participants to review the documents and answer Questions 1 and 2. Review answers before proceeding.
  - Instruct participants to answer Questions 3 and 4. Review the answers before proceeding.
  - Review with participants the additional background information provided as the introduction to Question 5. Instruct participants to answer Questions 5 and 6. Review the answers before proceeding.
  - Instruct participants to answer Question 7. Review the answers.
- Because participants must review multiple pieces of paper to collect information, less experienced participants may need assistance during the exercise. If the class includes a significant number of participants with little experience, consider having participants work in teams.
- Keep in mind that the ultimate objective is not to train participants to become experts in the details of business finance. Our goal is to ensure that participants understand basic principles of business income and business expenses, are able to recognize these principles at work when they see them in business documentation, and are able to make reasonable judgments and assessments of net business income to include in annual income.

Notes

PART I BUSINESS INCOME AND BUSINESS ASSETS

Overview

- The term “business” may apply in many different circumstances.
  - A family member could be the sole owner of a business, or a partner in a business with an individual outside the family.
  - A family member could be self-employed.
  - Farming, for example, would qualify as operation of a business.
- The physical location of the business does not affect whether the income is counted. Business income may come from:
  - Activities that are operated from the assisted unit (e.g., doing hair and nails, tutoring, child care)
  - Activities that take place in multiple locations (e.g., taxi services, delivery services, handyman services)
  - Businesses operated at a separate site (e.g., store, workshop, office building)
- Operating a business may involve many expenses. When a family member receives income from a business, the net income (after deducting eligible expenses) of the business is included in annual income.
- Assets from an active business are not included in the calculation of the *family’s* net assets.

Notes

Gross Income vs. Net Income

4350.3 REV-1, Par. 5-6G.

- Gross income is the total receipts of the business before any deductions are made.
- Net income is defined as the gross income minus expenses associated with the operation of the business, interest on qualified business loans, and straight-line depreciation of certain business assets.

	Gross Income
Less	Business expenses
Less	Interest on qualified business loans
Less	Straight-line depreciation of certain business assets
Equals	**Net Business Income**

- Examples of allowable business expenses can be found in the regulations at 24 CFR 5.609(b), and in handbook 4350.3 REV-1, Exhibit 5-1.

4350.3 REV-1, Exhibit 5-1

Example of the distinction between Gross and Net income:

Keisha works as a secretary during the week but works as a hair dresser on Saturdays. She rents a chair in a local salon. On the average Saturday she makes $200.

Gross income for Keisha's hair dresser job is $200/day.

Keisha's *gross income* for the year is $10,400:

- $200/day x 52 days = **$10,400**

Keisha must pay $50/day for rental of the chair and on the average spends about $500/year on supplies.

Her expenses for the year are $3,100:

- $50/day x 52 days = $2,600/year
- $2,600 + $500 = **$3,100**

Keisha's *net income* would be $7,300:

- $10,400 - $3,100 = **$7,300**

- If the net income from the business is negative, it cannot be used to offset other income the family may receive.
- In this instance, income from a business with a negative income is recorded as zero.

4350.3 REV-1, Par. 5-6G.3.

Loans as a Business Expense

4350.3 REV-1, Par. 5-6G.2., Exhibit 5-1

- Business loans represent a debt for the business. In paying off this debt, an individual's regular payment will include an amount that is applied to the *principal* portion of the debt and an amount designated to pay the *interest* owed on the debt.
  - The *principal* portion of the payment is used to pay back the amount borrowed.
  - The interest portion of the payment is used to pay for the cost associated with borrowing the money.
- Payments on the *principal* portion of a loan can never be used as a deduction from gross business income to determine net business income.
  - The principal payment represents costs that are already considered.
  - The individual is paying back the value of something (e.g., equipment, cash) that they have already received.
  - For example, if the individual takes a loan to pay for operating expenses (e.g., supplies and salaries), the business will deduct these expenses. To deduct the principal portion of a loan payment would be double-counting the expense.
  - Similarly, if the loan is for a capital item (such as buying a warehouse), the principal payments actually increase the equity value of the asset.

Notes

- Payments on the *interest* portion of some types of business loans *may* be used as a deduction from gross business income to determine net business income.
  - In contrast to principal payments, interest is an expense *not* otherwise considered.
  - In general, business expenses may include the interest portion of a payment on a business loan that is not related to a business expansion or capital improvement.

    Example:

    Anthony owns a body shop garage. He has a mortgage on the garage that he pays monthly. Anthony is able to deduct the interest payment on this mortgage, but not the principal payment, when determining net business income.
- Interest cannot be counted as a deductible business expense if the loan payment is for a loan related to c**apital improvements** or **business expansion.**
  - See the next section for a discussion of business expenditures related to capital improvements and business expansion.
- The owner should verify the purpose of any loan for which interest will be deducted by reviewing the loan documents.
- Generally, an individual with a business loan should be able to provide an *amortization* schedule that specifies which portion of the monthly loan payment is *interest* and which portion is *principal*.
  - This split between interest portion and principal portion of a payment will vary each month.

Notes

4350.3 REV-1, Par. 5-6G.2., Exhibit 5-1

Capital Improvements and Business Expansion

- Expenditures for capital improvements cannot be counted as a deductible business expense.
  - Capital improvements include any permanent improvements to real property (e.g., land, buildings, machinery) that increases the value and adds to the useful life of the property.
  - Major repairs such as the replacement of a roof, replacement of windows, are capital improvements.
  - The costs of capital improvements to business property are "capitalized" – i.e., recorded as business assets, not expenses to the business.

    Example:

    Anthony owns a body shop garage. Anthony pays to replace the roof on his garage. This expenditure cannot be deducted because the funds were spent for a capital improvement.

- Expenditures for **business expansion** cannot be counted as a deductible business expense.
  - Business expansion relates to expenditures intended to "grow" or increase the business in some way, beyond the current level and scope of the business.

    Example:

    Lucy is the sole proprietor of Java on the Move – a business that delivers coffee and snacks to construction sites and office buildings.

    Java has been so successful that she has decided to purchase a second van. Because Java is already an established business, purchase of the second van would be considered a business expansion. This expenditure could not be deducted because it is for a business expansion.

Notes

- Expenditures for capital improvements and business expansion could be simple cash outlays. However, given the typical size of such expenditures, they usually involve a business loan.
  - The basic features of loan payments – principal and interest – were discussed under **Loans as a Business Expense.**
  - Neither the interest nor the principal on a loan for capital improvements or business expansion could be used as an allowable deduction from gross business income to determine net business income.

Depreciation

- ***Depreciation*** refers to the lessening of the value of an asset over time.
- Under IRS tax rules, businesses can deduct depreciation for certain assets.
- There are two basic methods of depreciation:
  - *Straight-line depreciation* means subtracting an equal amount from the value of the asset over the expected useful life of the asset.
    - The asset will decrease in value at a steady rate over time.
  - *Accelerated depreciation* means that the asset loses value at different rates (not in equal amounts) over the useful life of the asset.
    - The asset decreases in value more quickly early in its useful life, then decreases at a slower rate later in its useful life.
- HUD permits only *straight-line depreciation* to be considered in calculating expenses for purposes of calculation of net business income.
- If accelerated depreciation has been used for tax purposes, the family must supply an accountant's calculation of the depreciation expense using straight-line depreciation.

4350.3 REV-1, Appendix 15-C, Par. H.

Notes

Amounts Distributed to Family Members

4350.3 REV-1, Par. 5-6G.1.

- In addition to counting the net income from the business, owners must include the following in annual income.
  - Salaries paid to family members from the business
  - Other amounts distributed to family members from the business (e.g., payment in the form of commissions, bonuses or profits)
- Regarding salaries paid to family members, it might appear that counting both the family's salaries and the family's business income would be "double-counting" the family's income.
  - However, all salaries are deducted from gross income as an expense of the business.
  - Therefore, salaries distributed to family members has been deducted before net business income is determined.

Notes

Family Investments in the Business

- A family might invest in its own business by providing cash loans to the business, or by contributing assets or equipment to the business.
- When the family withdraws cash or assets from the business, this cash or asset value must be counted as family income unless the withdrawal is a reimbursement of cash or assets invested in the business.

4350.3 REV-1, Par. 5-6G.1., Exhibit 5-1

  Example:

  To get her house cleaning business started, Xena needed $2,000 to purchase supplies, advertise and set up a business bank account. Xena took $2,000 from her personal savings account to do this.

  Once the business is on its feet and profitable, Xena plans to start taking a salary, but first she will withdraw $2,000 from the business to return to her savings account.

  The withdrawal of the $2,000 would be counted as a reimbursement of cash/assets invested in the business and would not be counted in annual income for Xena. (The $2,000 would also be counted as an expense to the business).

- The concept of "investment" to the business does not include the value of *labor* donated to the business.
  - A family member may contribute their own labor to the business, without compensation for the labor.
  - The family member could not later "withdraw" assets from the business on the premise that this withdrawal was simply reimbursement of labor "invested" in the business and, therefore, should not be counted as income.
  - The "withdrawal" from the business, in this case, would be considered a salary or compensation payment for labor, and would be counted as annual income to the individual.

Notes

Example:

Bill owns a cafe called Bill's Barbecue. His wife works at the restaurant (for no pay) 2 hours each morning to help get things started. Because business was good, Bill gives his wife $1,000 at the end of the year.

Her contribution to the business was unpaid labor and cannot be considered an investment by the family. Therefore, the $1,000 cannot be considered a reimbursement of assets invested, and must be considered family income.

(However, the $1,000 could be considered an expense for the business).

Business Assets

- In general, assets that are part of an active *business*, including business equipment and inventory, are excluded from net *family* assets.

4350.3 REV-1, Par. 5-6G.1., Exhibit 5-2

- Assets from a business that is no longer active would revert to the family and may be included in the family's net assets (to the extent that these items would otherwise qualify as assets).
  - Any income from those assets is counted as family income.

Notes

- Generally, the value of rental or other real property is counted as part of the family's net assets. However, if the sale or rental of real estate is the individual's main occupation, the value of the property is a business asset, not a family asset.

    Example:

    Hilda owns a house that she lived in for 40 years, up until the time she could no longer maintain the home and moved into the Section 8 development. Hilda rents out the house, but does not consider herself to be in the "real estate" or "rental" business.

    In this case, the house is not considered an active business asset but a family asset. Hilda's equity in the house is included in net family assets, and the amount of income generated by rental of the house is included in the calculation of income from assets.

Verification and Documentation

- Net income from a business generally is verified using documents provided by the family. These might include:
    - Tax returns
    - Audited or unaudited financial statements
    - Loan applications listing income derived from the business during the preceding 12 months
    - A notarized statement or affidavit as to net income realized from the business during the previous years
    - Copies of contracts for major purchases and leases for leasing costs
- A family's tax return is often the simplest way to verify a family's business expenses.

4350.3 REV-1, Appendix 15-C, Par. H.

Notes

- HUD recommends use of the following tax forms:
  - IRS Form 1040, Schedule C (for Small Businesses)
  - IRS Form 1040, Schedule E (for Rental Property Income)
  - IRS Form 1040, Schedule F (for Farm Income)
- There may also be occasions when third-party verification (written or oral) may be appropriate.
  - For example, a financial statement may list an expense for which the family cannot provide additional documentation.
  - The owner may need to contact a third party directly to confirm the expense.
- IRS Publication 535 may also be helpful for understanding small businesses.
  - However, owners are not expected to become tax experts. The family should provide documentation of business income and expenses.

Notes

Projecting Business Income

- Like all income, business income should be anticipated income, based on income projected to be received over the coming year.
- Generally, anticipating business income would start with current circumstances.
- The owner should work with the family to develop a realistic projection based on anticipated income and expenses for the coming year.
- The business may be experiencing rapid growth, which might argue for projecting a higher net income than for last year.
  - The business may be facing significant expenses this year, which might suggest the need to anticipate a reduction in net income.
  - If the family can verify changes that will take place during the year the owner may adjust the anticipated business income accordingly.
- If changes are likely but the circumstances after the change are not known, the owner should anticipate business income based upon current circumstances.
- People who operate small businesses don’t always keep complete and accurate financial records.
  - Owners need to work with families that have business income in order to obtain the best documentation possible.
  - Owners should inform families about the kinds of records that are needed in order to facilitate the calculation of anticipated net business income in future years.

CASE STUDY 1: THE CURLY-Q SALON

Background

It is May 10, 2005. Jackie Q. has come in for her annual recertification, to be effective August 1st. Based on your interview with Jackie, you know the following:

- Jackie is the sole proprietor of the Curly-Q hair salon. She rents the shop space, but she owns the furniture, the equipment and a small inventory of beauty products to service her customers.
- She originally got a small-business start-up loan, which she used to purchase the equipment and supplies she needed, as well as to pay the first months' rent and salary payments. The loan was for $4,000, with a loan term of 36 months at 12.50% interest rate. Her loan payments are $133.81/month. As of the end of 2004, she says that she still owed "about $1,800" on this loan.
- Curly-Q has two employees: Jackie and her assistant Connie (not a family member).
- Last year, Jackie paid herself a salary of $12,000 and paid her assistant Connie a salary of $8,000. She thinks salaries will stay the same this year because, so far, the year seems "slow" and the business isn't doing real well.

As part of the recertification process, to document her business income and expenses, Jackie submitted the following documents:

- An audited financial summary statement for 2004
- Schedule C from her 2004 tax return

Jackie believes her income will be lower this year than last year. So, to support this, she also submits an unaudited financial summary expense statement, comparing 2004 with the same income and expense figures for the first four months (January – April) of 2005.

Finally, Jackie provides you with a loan amortization schedule for her loan. The amortization schedule shows the breakdown of principal and interest payments for each of the 36 monthly payments, as well as the principal balance remaining after each payment.

All of these documents are provided on the pages that follow.

Assignment

Our goal is to establish annual income for Jackie Q.

For purposes of Case Study 1, this will mean determining the amount of income from Jackie Q's hair salon business. We are looking for enough information to determine the amount of "net income from operation of a business" for Jackie's salon that the owner should anticipate for the coming year.

Our strategy will be twofold:

1. Using the 2004 Financial Statement and Schedule C, we hope to gain a good understanding of business income from last year.
   - The two documents are based on the same business financial performance for the same time period. One would expect the financial information to be very similar. We will look for consistency between the two documents and also note areas where each document takes a different approach to presenting the same financial information.
   - Because our goal is net business income, we are also looking for eligible expense items that may be deducted to arrive at net business income. To do this, we must identify all relevant business expenses and differentiate between expenses that are eligible and ineligible for deduction.

2. The financial statement that compares 2004 results with year-to-date results for the first four months of 2005 should be useful in helping us project business income for the coming year.
   - Jackie has provided the document as evidence that business will be worse this year than last. Consequently, 2004 may not fairly represent her business income for 2005 and her income for 2005 may be lower than 2004 results.
   - We are trying to understand whether this will, in fact, be true. The 4-month report should be viewed in terms of how it might represent projected annual income for the entire year.

Financial Statement 2004

CURLY-Q HAIR SALON
Franklin Park Shopping Center, Suite 104
Anytown, USA

FINANCIAL STATEMENT - 2004
Submitted by Ivan Pennywise, C.P.A.

	2004 Amount	
INCOME		
Income from Services	$44,000	
Income from Product Sales	3,200	
Interest on Checking Account	110	
Gross Income	**$47,310**	
EXPENSES		
Rent for salon space	$12,000	
Utilities	1,200	
Salaries	19,000	
FICA and Medicare	1,454	
Liability Insurance	1,200	
Health Insurance	4,000	
Equipment	400	
Supplies	950	
Advertising	1,000	
Business License	125	
Taxes and Preparation	2,160	
Loan Payment	1,606	
Miscellaneous	1,100	
Total Expenses	**$46,195**	
NET INCOME	**$ 1,115**	
ASSETS		
Checking Account Balance	$ 1,200	
Equipment	4,000	Sink, chair, hoses, mirror,
Supplies Inventory	800	
Accounts receivable	250	
LIABILITIES		
Start-up Loan	$ 4,000	3 year term; 12.5% interest;
Outstanding Balance:	1,850	$131.81/month
Interest	320	
Accounts Payable	428	

SCHEDULE C (Form 1040)- pg 1

SCHEDULE C (Form 1040)

Department of the Treasury
Internal Revenue Service

Profit or Loss From Business

(Sole Proprietorship)

▶ Partnerships, joint ventures, etc., must file Form 1065 or 1065-B.

▶ Attach to Form 1040 or 1041. ▶ See Instructions for Schedule C (Form 1040).

OMB No. 1545-0074

2004

Attachment Sequence No. 09

Name of proprietor: Curly Q Hair Salon

Social security number (SSN): 123 45 7890

A Principal business or profession, including product or service (see page C-2 of the instructions)

B Enter code from pages C-7, 8, & 9 ▶

C Business name. If no separate business name, leave blank.

D Employer ID number (EIN), if any: 1 1 1 1 1 1 1 1 1

E Business address (including suite or room no.) ▶ Franklin Park Shopping Center, Suite 104
City, town or post office, state, and ZIP code: Anytown, USA 44444

F Accounting method: (1) ☑ Cash (2) ☐ Accrual (3) ☐ Other (specify) ▶

G Did you "materially participate" in the operation of this business during 2004? If "No," see page C-3 for limit on losses ☑ Yes ☐ No

H If you started or acquired this business during 2004, check here ▶ ☐

Part I Income

1	Gross receipts or sales. **Caution.** If this income was reported to you on Form W-2 and the "Statutory employee" box on that form was checked, see page C-3 and check here ▶ ☐	1	47,200 00
2	Returns and allowances	2	
3	Subtract line 2 from line 1	3	47,200 00
4	Cost of goods sold (from line 42 on page 2)	4	1,060 00
5	**Gross profit.** Subtract line 4 from line 3	5	46,140 00
6	Other income, including Federal and state gasoline or fuel tax credit or refund (see page C-3)	6	110 00
7	**Gross income.** Add lines 5 and 6 ▶	7	46,250 00

Part II Expenses. Enter expenses for business use of your home **only** on line 30.

8	Advertising	8	1,000 00
9	Car and truck expenses (see page C-3)	9	
10	Commissions and fees	10	
11	Contract labor (see page C-4)	11	
12	Depletion	12	
13	Depreciation and section 179 expense deduction (not included in Part III) (see page C-4)	13	
14	Employee benefit programs (other than on line 19)	14	5,854 00
15	Insurance (other than health)	15	1,200 00
16	Interest:		
a	Mortgage (paid to banks, etc.)	16a	
b	Other	16b	320 00
17	Legal and professional services	17	600 00
18	Office expense	18	12,000 00

19	Pension and profit-sharing plans	19	0 00
20	Rent or lease (see page C-5):		
a	Vehicles, machinery, and equipment	20a	
b	Other business property	20b	
21	Repairs and maintenance	21	
22	Supplies (not included in Part III)	22	600 00
23	Taxes and licenses	23	2,285 00
24	Travel, meals, and entertainment:		
a	Travel	24a	
b	Meals and entertainment: 25 00		
c	Enter nondeductible amount included on line 24b (see page C-5): 0 00		
d	Subtract line 24c from line 24b	24d	25 00
25	Utilities	25	1,200 00
26	Wages (less employment credits)	26	19,000 00
27	Other expenses (from line 48 on page 2)	27	75 00

28	**Total expenses** before expenses for business use of home. Add lines 8 through 27 in columns ▶	28	44,159 00
29	Tentative profit (loss). Subtract line 28 from line 7	29	2,091 00
30	Expenses for business use of your home. Attach **Form 8829**	30	0 00
31	**Net profit or (loss).** Subtract line 30 from line 29. • If a profit, enter on **Form 1040, line 12,** and **also** on **Schedule SE, line 2** (statutory employees, see page C-6). Estates and trusts, enter on Form 1041, line 3. • If a loss, you **must** go to line 32.	31	2,091 00

32 If you have a loss, check the box that describes your investment in this activity (see page C-6).
• If you checked 32a, enter the loss on **Form 1040, line 12,** and **also** on **Schedule SE, line 2** (statutory employees, see page C-6). Estates and trusts, enter on Form 1041, line 3.
• If you checked 32b, you **must** attach **Form 6198.**

32a ☐ All investment is at risk.
32b ☐ Some investment is not at risk.

For Paperwork Reduction Act Notice, see Form 1040 instructions. Cat. No. 11334P **Schedule C (Form 1040) 2004**

SCHEDULE C (Form 1040)- pg 2

Part III **Cost of Goods Sold** (see page C-6)

33 Method(s) used to value closing inventory: a ☑ Cost b ☐ Lower of cost or market c ☐ Other (attach explanation)

34 Was there any change in determining quantities, costs, or valuations between opening and closing inventory? If "Yes," attach explanation . . . ☐ Yes ☑ No

35	Inventory at beginning of year. If different from last year's closing inventory, attach explanation	35	500	00
36	Purchases less cost of items withdrawn for personal use	36	750	00
37	Cost of labor. Do not include any amounts paid to yourself	37		
38	Materials and supplies	38		
39	Other costs	39		
40	Add lines 35 through 39	40	1,250	00
41	Inventory at end of year	41	190	00
42	**Cost of goods sold.** Subtract line 41 from line 40. Enter the result here and on page 1, line 4	42	1,060	00

Part IV **Information on Your Vehicle.** Complete this part **only** if you are claiming car or truck expenses on line 9 and are not required to file Form 4562 for this business. See the instructions for line 13 on page C-4 to find out if you must file Form 4562.

43 When did you place your vehicle in service for business purposes? (month, day, year) ► ____/____/____ .

44 Of the total number of miles you drove your vehicle during 2004, enter the number of miles you used your vehicle for:

a Business ______________ b Commuting ______________ c Other ______________

45 Do you (or your spouse) have another vehicle available for personal use? . . . ☐ Yes ☐ No

46 Was your vehicle available for personal use during off-duty hours? . . . ☐ Yes ☐ No

47a Do you have evidence to support your deduction? . . . ☐ Yes ☐ No

b If "Yes," is the evidence written? . . . ☐ Yes ☐ No

Part V **Other Expenses.** List below business expenses not included on lines 8–26 or line 30.

Postage and Photocopying		25	00
Charity contributions (Big Brothers of America)		50	00
48 **Total other expenses.** Enter here and on page 1, line 27	48	75	00

Schedule C (Form 1040) 2004

Loan Amortization Schedule

Loan Amount:……………………………………$4,000
Loan Term:…………………………………………36 months
Interest Rate:…………………………...………12.50%
Payment per Month:…………………………$133.81

Pymt No.	Principal	Interest	Balance
			4,000.00
1	92.14	41.67	3,907.86
2	93.10	40.71	3,814.76
3	94.07	39.74	3,720.69
4	95.05	38.76	3,625.64
5	96.04	37.77	3,529.60
6	97.04	36.77	3,432.56
7	98.05	35.76	3,334.51
8	99.08	34.73	3,235.43
9	100.11	33.70	3,135.32
10	101.15	32.66	3,034.17
11	102.20	31.61	2,931.97
12	103.27	30.54	2,828.70
13	104.34	29.47	2,724.36
14	105.43	28.38	2,618.93
15	106.53	27.28	2,512.40
16	107.64	26.17	2,404.76
17	108.76	25.05	2,296.00
18	109.89	23.92	2,186.11
19	111.04	22.77	2,075.07
20	112.19	21.62	1,962.88
21	113.36	20.45	1,849.52
22	114.54	19.27	1,734.98
23	115.74	18.07	1,619.24
24	116.94	16.87	1,502.30
25	118.16	15.65	1,384.14
26	119.39	14.42	1,264.75
27	120.64	13.17	1,144.11
28	121.89	11.92	1,022.22
29	123.16	10.65	899.06
30	124.44	9.37	774.62
31	125.74	8.07	648.88
32	127.05	6.76	521.83
33	128.37	5.44	393.46
34	129.71	4.10	263.75
35	131.06	2.75	132.69
36	132.69	1.38	0.00

Financial Statement Comparison 2004

CURLY-Q HAIR SALON
Franklin Park Shopping Center, Suite 104
Anytown, USA

FINANCIAL STATEMENT
COMPARISON – 2004 vs YTD 2005

	2004 Amount	**Jan-April 2005 Amount**
INCOME		
Income from Services	$44,000	$14,000
Income from Product Sales	3,200	800
Interest on Checking Account	110	32
Gross Income	**$47,310**	**$14,832**
EXPENSES		
Rent for salon space	$12,000	$ 4,000
Utilities	1,200	400
Salaries	19,000	6,333
FICA and Medicare	1,454	485
Liability Insurance	1,200	1,200
Health Insurance	4,000	2,000
Equipment	400	0
Supplies	950	150
Advertising	1,000	100
Business License	125	0
Taxes	2,160	648
Loan Payment	1,606	535
Miscellaneous	1,100	50
Total Expenses	**$46,195**	**$15,901**
NET INCOME	**$ 1,115**	**– $ 1,069**
ASSETS		
Checking Account Balance	$ 1,200	$ 1,200
Equipment	4,000	4,000
Supplies Inventory	800	800
Accounts receivable	250	0
LIABILITIES		
Start-up Loan	$ 4,000	
Outstanding Balance	1,850	$ 1,384
Interest	320	70
Accounts Payable	428	350

Question 1: Business INCOME on the Statements

a. We begin with the 2004 Financial Statement and Schedule C. Based on a review of these two documents, what might you use for the following figures?

	Financial Statement	Schedule C
Gross Business Income:		
Gross Business Expenses:		
Net Business Income:		

b. Focusing only on business ***income***, what appears to be the major difference between the gross income figures from the Financial Statement and Schedule C?

Question 2: Business EXPENSES on the Statements

a. **Readily Identifiable Expenses:** For identifying expenses, we'll start by looking for the obvious similarities between the 2004 Financial Statement and Schedule C. Both documents have several expenses and expense items that are the same, but referred to slightly differently on each form. The following chart lists expenses from the 2004 Financial Statement that should be readily identifiable as the same expenses on Schedule C. For each expense, identify where this expense is also found on Schedule C.

Amount	Financial Statement Description	Schedule C	
		Part II Line No.	Description
$12,000	Rent for Salon Space		
$1,200	Utilities		
$19,000	Salaries		
$1,000	Advertising		
$125	Business License		
$2,160	Taxes and Preparation		

b. **Miscellaneous Expenses:** The 2004 Financial Statement has a category of expenses labeled "miscellaneous" that is not readily identifiable on Schedule C. This category is relatively large – $1,100 – and not defined well enough to categorize it as a deductible business expense for calculating net business income. You ask for clarification from Jackie and she offers the following breakdown from her accountant, Ivan Pennywise:

Amount	Expense Item
$600	Accountant
$400	Bonus for Employee
$50	Charity
$25	Postage
$25	Food
$1,100	Total Miscellaneous

- With this additional information, you can now match up more 2004 Financial Statement expenses with their corresponding expenses on Schedule C.
- The following chart lists expenses from Schedule C that should now be readily identifiable as the same expenses on the Financial Statement. For each Schedule C expense category, identify the description and amount of the expense as recorded on the 2004 Financial Statement.

Amount	Schedule C		Financial Statement Description
	Part II Line No.	Description	
$5,854	14	Employee benefit programs	
$600	17	Legal and professional services	
$25	24b	Meals and entertainment	
$75	27	Other expenses (from line 48 on page 2)	

c. **Equipment and Supplies Expenses:** The 2004 Financial Statement includes general categories for “Equipment” ($400) and “Supplies” ($950) that are not readily identifiable on Schedule C.

- In discussing these categories with Jackie, you discover that the “equipment” category ($400) really includes things like scissors, brushes, and other smaller, non-capitalized equipment items used around the store. The “supplies” category ($950) includes hair products like shampoo, conditioner, hair gel, etc. Some of these products Jackie purchased for use as part of the business ($200) and some products Jackie purchased in order to sell to customers ($750).
- So, taking these two categories together, it appears that $600 ($400 + $200) worth of expenses are for equipment and supplies purchased for use by Jackie in the business and $750 worth of expenses are for products purchased to sell to customers.

\- Examine Schedule C. How do you see these figures reflected on Schedule C?

Question 3: A Business Loan

As noted earlier, Jackie has a small business loan. In a prior reexamination, you established that the purpose of the loan was as Jackie has stated – a small business loan used to start up her business, back in 2003.

Up to this point, you've been able to account for all potential business expenses except the loan. Here's another area where the Financial Statement and Schedule C differ in their approach to recording loan information.

a. What expense do you see on the Financial Statement that is related to the business loan and how was this expense calculated?

b. What do you see on Schedule C that looks like it could be related to the business loan?

c. What does this tell you about the key difference between business loan expense reflected on Jackie's 2004 Financial Statement and business loan expense reflected on Schedule C?

d. How will you handle principal and interest payments on Jackie's loan, in order to establish net business income for the recertification year beginning August 1st?

e. Jackie refers to her loan amortization schedule and indicates that loan payment no. 21 was her payment for December 2004. Loan payments no. 22 through no. 25 covered the first four months of 2005 (January – April) and she just made loan payment no. 26 for May 2005.

- For the recertification period beginning August 1, 2005, provide the following information:

Total Principal to be paid in recertification year beginning August 1, 2005:	$	
Total Interest to be paid in recertification year beginning August 1, 2005:	$	

Question 4: Comparing 2004 Business Performance with 2005

a. As noted earlier, Jackie believes that 2005 will be "worse" than 2004. The Financial Statement Comparison form shows data from January through April of 2005, which is 1/3 (33%) of the 2005 calendar year. Looking at the Financial Statement Comparison form, why might Jackie think that her business is not doing well so far in 2005?

b. Look at the Financial Statement Comparison form and compare 2004 expenses with year-to-date 2005 expenses. Logically, you might expect year-to-date 2005 expenses to be about 1/3 (33%) of 2004 expenses. What do you see that might cast doubt on Jackie's assessment that her business is not doing as well so far in 2005 as it did in 2004?

c. In comparing 2004 results with year-to-date 2005 results, what do you see that might support Jackie's assessment that her business is not doing as well so far in 2005 as it did in 2004?

Question 5: Tying up Loose Ends

You discuss Jackie's business further and determine the following:

- As suspected, liability insurance premiums are a once-per-year premium, paid at the beginning of the year. No further payments will be made until January 2006.
- As suspected, health insurance is paid twice per year – January and July. Next payment will be made in July.
- Jackie has yet to pay her business license for 2005, but must pay it before the end of the year.
- Jackie expects Salaries, FICA, Medicare and Taxes to be the same amount as 2004.
- Jackie has no plans to hire additional people or to expand. Nor does she expect to pay any bonuses this year.
- Regarding her other expenses, Jackie has not purchased any new shop "equipment" for the year and doesn't anticipate any for 2005. Right now, she doesn't know about 2006.
- Jackie expects that her payments for rent, utilities, advertising, and miscellaneous expenses will be at about the same rate for the rest of 2005 as they have been so far in 2005.
- Regarding her income, Jackie has no idea if her business income might increase or if she will get more clients as the year goes. She hopes so but, for the time being, she thinks her business income will stay at about the same rate for the rest of the year as it has been so far this year.

Taking all of the information you have gathered, you are satisfied that the Financial Statement and the Financial Statement Comparison forms are consistent with Schedule C tax information and offer a reasonably accurate picture of Jackie's business income and expenses. There remain two areas where you may need to adjust the Financial Statement figures when projecting income and expenses for the coming year.

a. The financial statements reflect both principal and interest in the monthly loan payments. If you base your projection solely on financial statement data, you will calculate an annual loan expense of $1,606.

What figure will you use for the loan expense for the recertification year beginning August 1, 2005? Explain your answer below.	$	

b. Based on your earlier review, you know that Schedule C makes a distinction between supplies purchased for business use (an expense) and supplies purchased to add to inventory and sell to customers. The financial statements do not make this distinction and include all supplies under one expense category.

- You discuss this distinction with Jackie. Jackie notes that she has spent $150 on supplies so far in 2005 and expects to buy supplies at that same rate for the remainder of the year. This would be $450 in supplies for 2005 ($150 x 3).
- Of that amount, Jackie estimates that about $250 of the supplies will be for business use and about $200 will be to sell to customers. Further, she expects to sell about the same amount of supplies that she buys for 2005.

\- Based solely on this information, how will you categorize supplies for 2005? Explain your answer.

Question 6: Using the Information to Project Ahead

a. We should now have enough information to make a reasonable projection of Jackie's business income and expenses for the coming year. The following charts are based on the categories from the financial statements, with a few adjustments.

- Establish a 12 month projection for the business income and expenses.

Income	Jan – April 2005	Calculation	12-month Projection
Income from Services	$14,000		
Income from Product Sales	$800		
Interest on Checking	$32		
Costs of Goods Sold	NA		
Gross Income:	$14,832	---------------------------	

Expenses	Jan – April 2005	Calculation	12-month Projection
Rent for Salon Space	$4,000		
Utilities	$400		
Salaries	$6,333		
FICA and Medicare	$485		
Liability Insurance	$1,200		
Health Insurance	$2,000		
Equipment	$0		
Supplies	$150		
Advertising	$100		
Business License	$0		
Taxes	$648		
Loan Payment	$535		
Miscellaneous	$50		
Total Expenses:	$15,901	---------------------------	

Net Income	-$1,069	---------------------------	

b. What observations might you make which could explain the results?

Question 7: Annual Income

Assuming that the business is Jackie's only source of income, except for $86 in anticipated interest on her personal checking account, complete the following income portion of the rent calculation form.

3. Total Asset Income	Greater of **Line 2.** or **1e. Total**	$86

Annual Income

4a. Family Member Name	4b. FM #	Calculation	4c. Employment or Business	4d. Social Security, Pensions, etc.	4e. Public Assistance	4f. Other Income
4g. Total Income from each source			$	$	$	$
5. Total Income All Sources		Add all amounts on **Line 4g.** above:				$
6. Total Annual Income		Add **Line 5.** + Total Asset Income:				$

TRAINER NOTES: APPROACH TO CASE STUDY 2 AND PRESENTATION MATERIALS

Purpose

- Case Study 2 illustrates asset and income calculations required when a family member owns real estate and is not engaged in real estate as a profession.
- The written materials in Part II summarize Handbook 4350.3 REV-1 requirements related to real estate owned by family members.

Materials

- The Part II materials discuss the following key concepts related to income from real estate:
  - How to determine the market and the cash value of the asset
  - Counting the net (rather than gross) income related to the real estate
  - Treatment of real estate that is owned jointly by assisted and non-assisted persons.
- The case study introduces the Barker family and asks participants to determine the value of a property that Robert and his three brothers have inherited from their mother. It also requires participants to analyze expenses to determine the net income that must be included in annual income.
- Already verified information about family composition, income from other sources and deductions from income are provided. Participants are asked only to review documents related to the real estate including:
  - Property tax assessment
  - Water/sewer assessment
  - An income and expense report and a receipt for some expenses
- Questions 1-4 relate to valuing the real estate; questions 5-7 relate to determining net income.
- Participants are asked to complete a full income and rent calculation using the information provided.
- Answers to the case study are found on page 5-121 in the Participant Manual.

Presentation vs. Review

- In a conference call format, participants are expected to have completed the case study in advance.
- In a classroom training setting, Part II should be presented as an interactive discussion and participants should complete the case study in class.

Tips and Cautions

- Remember to make clear that the policies illustrated in the case study apply when the family member is not engaged in real estate as a profession.
- As with case study 1, a staged approach to the case study is recommended. After explaining the background, ask participants to stop after question 4, discuss and review the answers, then proceed to the next block of questions.
- Because participants must review multiple pieces of paper to collect information, less experienced participants may need assistance during the exercise. If the class includes a significant number of participants with little experience, consider having participants work in teams.
- Again, similar to case study 1, our objective here is not real estate training, per se. We want to ensure that participants understand basic principles of real estate ownership, income and expenses, are able to recognize these principles at work when they see them in documentation, and are able to make reasonable judgments and assessments of the value of real estate as an asset to the family, as well as any net real estate income to include in annual income.

PART II REAL ESTATE

Overview

- While it is uncommon for families living in subsidized housing to own real estate, there are many reasons why it is possible, including:
  - A person who now rents an assisted unit owns a prior residence (such as a house) but has not yet sold it
  - A family member living in an assisted unit inherits all or a portion of a real property (e.g., family member inherits a house and land from a deceased relative)
  - A family member owns property as an occupation as part of an active business (e.g., a contractor who buys houses, rehabilitates them, and sells them)
- How real property is treated depends upon whether the real estate is owned as a family asset or by a family member whose main *occupation* is real estate.
  - This Part II addresses only situations in which property is owned by the family as an asset, and real estate is not the primary occupation of a family member.
  - Where a family member's main occupation is buying, selling, or renting real estate, the family member has a real estate business.
    - Owners should follow the rules discussed in Part I for counting net income from a business.
    - In this case the real property is not counted as a family asset.

Notes

- If the family member's primary occupation is not real estate, HUD regulations require owners to:
  - Count the equity in real property owned by a family member as an asset
  - Count the net income from the real property asset in the annual income calculation
- Two types of real estate are *never* counted as family assets:
  - Equity in a cooperative unit in which a family lives
  - Interests in Indian trust lands

Determining Equity in Real Property

- The equity in real property is its ***cash value***.
- To determine the cash value of real estate, use the following calculation.

4350.3 REV-1, Exhibit 5-2

	Current market value of the property
Less	Unpaid balance of loans secured by property
Less	Other costs that would be incurred in converting asset to cash (e.g., broker and legal fees, settlement costs, penalties, etc.
Equals	Cash value of property (equity)

- ***Market Value*** may be determined from appraisals and real estate tax statements (if the tax authority uses approximate market value).
- ***Loans*** may include mortgages on the property and liens on the property (e.g., tax or construction liens).
  - *Unpaid balance* refers to unpaid current principle on the loan.

Notes

- ***Costs*** that would be incurred to convert property into cash may be verified through a letter or document obtained from a third party, such as an attorney, stockbroker, banker, or real estate agent.
  - A verbal “quote” from such a qualified individual provided by the family may also be accepted.
- The cash value of the property must be determined regardless of whether the property generates income.
- If the property is co-owned, the owner should prorate its cash value according to the percentage owned by a family member.

Actual Income from Real Estate

- Any net income from the property must be counted as asset income.
  - The most common type of income from property is rental income.
  - A family member may own a house, land or other real estate that the family member rents out.
  - In this context, income from the property does not refer to real estate income as a primary occupation.
- The formula for calculating net income from a real estate asset is similar to the formula for calculating net business income.

	Gross (Rental) Income
Less	Expenses
Less	Interest on qualified loans
Equals	Net Income

- If the net income from the property is negative, it cannot be used to offset other income.
  - In this instance, income from the asset is recorded as zero.

Notes

- Because the real estate is a *family* asset, as opposed to a business asset, depreciation of the asset is not allowed.
- If real estate income is sporadic (e.g., frequent turn-over in tenants, frequent non-payment of rent) the owner should work with the family to develop a realistic estimate of anticipated income.

Income from Real Estate Example:

Ingrid E. inherited residential rental property in another state. She has a stable tenant who pays $750/month ($9,000 per year). She has a mortgage payment of $342 ($4,104 per year).

	$9,000	(Gross Income)
Less	$3,900	(taxes, insurance, maintenance and utilities)
Less	$2,232	(Interest on the mortgage)
=	$2,868	Net income

- Note that this is Ingrid's *net* income from the business. We were not able to deduct the principal portion of her mortgage payment as an expense. Therefore, the actual income in-pocket that Ingrid receives from her business will be considerably less than $2,868. But Ingrid's equity in the property is increasing little-by-little because of the principal she pays.

CASE STUDY 2: THE BARKERS

Background

Today is March 10, 2005. You are working on the recertification to be effective May 1, 2005.

The Barker family: Robert (35, head), Vana (31, spouse, disabled) and their children Sally Jesse (12) and Oprah (10) live in a three bedroom unit in your development. The contract rent for the unit is $1,100 and the utility allowance is $95.

They have reported their income and other family circumstances on your recertification form. Most of their situation is pretty straightforward. You have verified the following (Note: these verification forms not included in this case study):

- Income information reported by Robert on the recertification form, verified through employment verification directly from Robert’s employer
- Savings and checking account balances and interested earned, as reported by the Barkers on the recertification form
- Medical expenses (hospital bill, prescriptions, doctor’s visits) reported by the Barkers on the recertification form

Vana Barker’s status as a person with disabilities was verified at an earlier recertification and remains unchanged.

Two years ago Robert inherited a share of the family home that had been occupied by his mother until her death. The home is co-owned by Robert and his three brothers – Richard, Randal and Russell. As part of the estate settlement, the property was appraised at $90,000. There was no outstanding mortgage on the house. At a previous recertification, Robert provided you with a recorded deed that confirms Robert as co-owner of the house, along with his brothers.

The brothers have not yet decided whether they can part with the home, and have been renting it out. However, Mother Barker had lived in the house a long time. It's small and hadn't been updated for years. A little over one year ago, the brothers took out a loan of $30,000, using the value of the house to secure the loan. With the money, the brothers made a number of improvements on the home last year.

The loan is a 10 year loan with an annual interest rate of 10.5%. The brothers make monthly payments of $404.80. Robert provides you with several current pieces of information about the home.

On the pages that follow, you will find:

- Excerpts from the recertification form completed by the Barkers
- Copy of the most recent tax assessment on the home owned by the brothers
- Copy of a notice of change in water/sewer/trash assessment for the home
- Copy of a receipt for new carpeting for the home
- Income and expense report for the home, for calendar year ending December 31, 2004

Using this information, answer the questions that follow.

Housing Recertification Excerpt

HOUSEHOLD COMPOSITION AND CHARACTERISTICS

List all family members who will be living in the unit. Include additional information listed.

Mem. No.	Full Name	Relation to Head	Birth Date	Sex	SSN	Occupation or School	C/EI* Y/N	Dis* Y/N	FTS* Y/N
1	Robert Barker	Head	7/11/69	M	123-45-6789	Flooring	Y	N	N
2	Vana Barker	Spouse	8/12/73	F	123-45-6788	NA	Y	Y	N
3	Sally Jesse Barker	Dau.	9/1/92	F	123-45-6787	School	Y	N	Y
4	Oprah Barker	Dau.	10/4/94	F	123-45-6786	School	Y	N	Y
*NOTE: "C/EI" refers to Citizenship or Eligible Immigration status; "Dis" refers to Disability status; "FTS" refers to Full-Time Student status.									

EMPLOYMENT INCOME

Is any member of the family employed (including self-employed), or expected to be employed in the next 12 months?

☑ Yes ❑ No

If "Yes", complete table below.

Mem. No.	Employer Name Address Phone No.	Regular Income Rate (income per hour, per week, per month, etc.)	Other income (overtime, bonuses, tips, commissions, etc.)	Estimated Gross Annual Income
1	Floors, Tiles & Carpet	$7.50/hour x 32 hours/week x 48 weeks/year	None	$11,000 or so

OTHER INCOME

Complete the "Other Income" chart (here's an excerpt from that chart):

Income Item	Yes	No	Family Member
Other, Explain: *Rental Income*	☑	❑	Robert

Where you checked "Yes" for any items, provide additional detail in the chart below.

Mem. No.	Other Income Item (from chart)	Income Provider Name Address Phone No.	Other income rate (income per hour, per week, per month, etc.)	Estimated Gross Annual Income
1	Rental Income from house	John Q. Tenant	$300/month	$3,000 or so

ASSETS AND ASSET INCOME

Complete the "Asset" chart (here's an excerpt from that chart):

Asset	Yes	No	Family Member
Checking Account(s)	☑	❑	Robert and Vana
Savings Account(s)	☑	❑	Robert and Vana
Savings Account	☑	❑	Sally Jesse
Savings Account	☑	❑	Oprah

Where you checked "Yes" for any asset, provide additional detail in the chart below.

Mem. No.	Asset Type (from chart)	Asset Name Asset Provider Account No.	Current Value of Asset	Estimated Gross Annual Income from Asset
1,2	Checking	Eighth National Bank	$200	None
1,2	Savings	Eighth National Bank	$600	$10 (1.67% int)
3	Savings	Eighth National Bank	$100	None
4	Savings	Eight National Bank	$100	None

Have any adult family members sold or disposed of any business or asset in the past 2 years? ❑ **Yes** ☑ **No**

CHILD CARE

Do you employ the services of a Care Provider for a child 12 years old or younger? ❑ **Yes** ☑ **No**

DISABILITY ASSISTANCE EXPENSES

Do you employ the services of a Care Attendant, or do you pay for any equipment, for any household member(s) with disabilities, in order to permit any family member to work? ❑ **Yes** ☑ **No**

MEDICAL EXPENSES

The family head of household and/or the spouse of the head of household are: a) 62 years of age or older;
b) handicapped; or
c) disabled? ☑ **Yes** ❑ **No**

If "Yes", indicate estimated costs to the family for medical expenses (for example - medications, medical/dental treatments, medical insurance, prescribed medical appliances, etc.) which are not reimbursed by an outside source.

Medical Insurance:	Nice Health Insurance (through Robert's work)	
Outstanding Medical Bills:	**Balance Amount**	**Amount Paid per Month**
	$5,000	$100/month
	Hospital Bill with Nice Hospital	
Prescription Drugs:	**Amount Paid per Month**	
	$150/month (Family)	
	Amounts confirmed with printout from Nice Pharmacy	

Other Potential Medical Expenses (Describe):

Family pays $80 monthly for regular doctor visits by Vana. These expenses are not covered by Robert's health insurance.

Notice of Tax Assessment

Nice Town USA
Office of the Treasurer
4444 Fourth Street
Nicetown, USA 22222

NOTICE OF TAX ASSESSMENT

March 1, 2005

Property:	983 Elm Street	
	Nicetown, USA 22222	
Owner(s) of Record:	Robert Barker; Richard Barker; Randal Barker;	
	Russell Barker	
Assessed Value:	$45,000	
Tax Rate:	35/1000 of assessed value	
Property Taxes Due:	**June 1:**	$788
		$866 if not paid by due date
	December 1:	$787
		$866 if not paid by due date

Notes:

Assessed value represents approximately 40% of market value

Assessments are updated by survey every five years

Written appeals to the assessment may be made to the Office of the Treasurer

Notice of Change in Water/Sewer/Trash Assessment

Nice Town USA
Office of the Treasurer
4444 Fourth Street
Nicetown, USA 22222

NOTICE OF CHANGE IN WATER/SEWER/TRASH ASSESSMENT

March 1, 2005

This notice informs the owners of an increase in the city assessment for water service, sewer service, and trash collection. Increase is effective May 1, 2005.

Current Assessment:

Multifamily Units:	$35/quarter/unit
Single Family Units:	$45/quarter

Assessment Effective May 1, 2005:

Multifamily Units:	$38/quarter/unit
Single Family Units:	$50/quarter

Carpeting Receipt

Carpets 'R Us

"We've Got You Covered"

RECEIPT

DATE:	July 15, 2004
ITEM:	Wonderfiber Shag – Green 1000 sq. ft. @ $1.10/ft.
COST:	$1,100.00
TAX:	93.50
TOTAL:	$1,193.50
SOLD TO:	Robert Barker Nicetown, USA

Thanks for your business!

Income and Expense Report

983 Elm Street

Nicetown, USA

January 1, 2004 – December 31, 2004

INCOME	
Rent	$10,800
Late Fees	200
Total	**$11,000**
EXPENSES	
Utilities:	
Water/Sewer/Trash	$ 180
Gas	900
Electricity	400
Regular Maintenance and Supplies	300
Damage Repair (Johnson family)	900
Improvements (new carpeting) *	1,400
Taxes	1,680
Management Fee *	635
Travel	450
Telephone	240
Loan Payments *	4,858
Total Expenses	**$10,431**
NET INCOME:	**$ 569**

*** Notes:**

Improvements (new carpeting) includes labor charges of $206.50

Management fee approximately 4.5% of rental income

Loan payments based on $404.80/month for 12 months

Question 1

You have concluded that the house is an asset for Robert.

- What are the three basic pieces of information you will need in order to establish the **cash value** of the house?

Question 2

It is unlikely that the appraised value of the house ($90,000 at the time the brothers inherited the house) is still valid, given that the brothers have invested an additional $30,000 in house improvements. Review the forms provided by Robert.

- Based solely on this information, how would you calculate the **market value** of the house at this time?

Question 3

Given that the house was used to secure the $30,000 loan, you will need to determine the unpaid balance of this $30,000 loan.

Following is an excerpt from an amortization schedule for the loan. The schedule shows the loan payments (principal and interest) for the period of time that overlaps with the recertification period (May 1, 2005 through April 30, 2006):

Payment No.	Principal	Interest	Cumulative Principal	Principal Balance
13 (Apr. 05)	$157.98	$246.82	$1,950.22	$28,049.78
14 (May 05)	$159.36	$245.44	$2,109.58	$27,890.42
15 (June 05)	$160.76	$244.04	$2,270.34	$27,729.66
16 (July 05)	$162.17	$242.63	$2,432.51	$27,567.49
17 (Aug. 05)	$163.58	$241.22	$2,596.09	$27,403.91
18 (Sept. 05)	$165.02	$239.78	$2,761.11	$27,238.89
19 (Oct. 05)	$166.46	$238.34	$2,927.57	$27,072.43
20 (Nov. 05)	$167.92	$236.88	$3,095.49	$26,904.51
21 (Dec. 05)	$169.39	$235.41	$3,264.88	$26,735.12
22 (Jan. 06)	$170.87	$233.93	$3,435.75	$26,564.25
23 (Feb. 06)	$172.36	$232.44	$3,608.11	$26,391.89
24 (Mar. 06)	$173.87	$230.93	$3,781.98	$26,218.02
25 (Apr. 06)	$175.39	$229.41	$3,957.37	$26,042.63

- Based on the table, what would you say is the unpaid balance of the $30,000 loan secured by the property? $

Question 4

You contact a couple of local real estate agents and both verbally confirm that, at this point in time, should the Barker brothers decide to sell the home, the estimated costs, commission and fees associated with the sale would be about $5,000.

a. Relying on the information you have, what would be the Cash Value of the house co-owned by Robert Barker?

b. Based on your answer to 4.a., what will you count as an asset for Robert Barker?

Question 5: Gross Asset Income

The brothers currently have a tenant in the house, with an executed lease for the period of January 2005 through December 2005. Robert provides you with a copy of that lease (not included with this case study) which shows that the lease has been executed with John Q. Tenant for the 12-month period beginning January 1, 2005, at a monthly rental rate of $1,200.

However, Robert reports that the brothers have had trouble keeping tenants in the house. They seem to keep getting tenants who stay for a few months, then leave. Last year, they only received $10,800 in rent (as evidenced by the income and expense report). The year before (2003), the brothers received only $9,600 in rent.

- How would you anticipate ***gross income*** for the property in the coming year?

Question 6: Asset Expenses

You examine the Income and Expense Report for the house, as well as the receipt provided by Robert to support one expense item (new carpeting).

a. You notice that the receipt for the carpeting shows an expense of $1,193.50. You also note that the income and expense report shows an expense of $1,400, with a note that the improvements include labor charges of $206.50. Robert explains that he purchased the carpeting, installed it himself during his vacation and decided to include some charge for his labor. He figured that an additional $200 or so was about right for the job, and so claimed a reimbursement for an even $1,400.

   - Is it OK for Robert to charge for his labor?
   - Should we count the $206.50 as income for Robert?
     Explain your answers below.

b. You notice that the income and expense report shows an expense of $635 for a “management fee.” Robert explains that his brother Russell takes the lead responsibility for “managing” the property (e.g., maintenance, leasing, etc.). Russell charges a management fee of about 4.5% of rental income. Because Russell lives out of town, he also incurs travel and long distance telephone expenses related to communication with the brothers about the property, as well as travel to the property for inspections and repairs.

- Is it OK for Russell to charge a management fee, as well as charge for travel and telephone expenses? Explain your answer below.
  - Yes
  - No

c. You notice that the income and expense report shows an expense of $900 for “damage repair.” Robert explains that their prior tenants, the Johnson family, left considerable damage to the house. Robert notes that Russell collects a damage deposit of $500, but it was not sufficient to cover the damages left by this particular family. Robert states that “you never know about people”, and that there is just no way to tell if their current tenant family or the next tenant family will also leave with similar damages.

- Will you allow the damage repair expenses again this year? Explain your answer below.
  - Yes
  - No

d. Robert provides you with the following additional pieces of information about the expenses listed on the income and expense report.

- Water/sewer/trash expenses are expected to go up for the coming year, as evidenced by the Notice of Change in Water/Sewer/Trash Assessment provided by Robert.
- Gas and electricity expenses will be about the same. No changes are anticipated in gas or electric rates. Robert provides you with copies of recent utility receipts that support these expenses.
- Robert states that the brothers are not anticipating any additional improvements for the coming year.
- As the “manager” of the house, Russell takes care of the regular maintenance and supplies on the house. Robert states that Russell did not keep copies of the any receipts for maintenance and supplies, but believes the $300 total to be “about right.” Robert also expects Russell to continue to charge the same management fee and incur the same phone expenses in the coming year. The brothers have planned a face-to-face meeting next quarter about selling the house. Robert suggests that using the same travel expenses as last year will cover that meeting. Robert signs a certification attesting to the accuracy of the amounts.
- Robert explains that the brothers were late on one of their tax payments last year. As a result, the taxes they paid ($1,680) were a little more than what they would have paid (about $1,500) if they had paid on time. Robert has provided you with a copy of the current Notice of Tax Assessment.

The following chart lists all of the expense items from the Income and Expense Report for 2004. Based on all of the information you have, complete the chart.

- Indicate the amount of the expense you will count as anticipated expenses for the coming year, and the amount that you will not count, for purposes of computing net income on the house.
- Where there are additional expenses you will count that are not listed, add them to the chart.
- Give a brief explanation of your decision for each expense item.

	Annual Amount	
Expense Item	**Counted**	**Not Counted**
Water/Sewer/Trash		
Gas		
Electricity		
Regular Maintenance and Supplies		
Damage Repair		
Improvements		
Taxes		
Management Fee		
Travel		
Telephone		
Loan Payments		
Other:		
Other:		
Total:		

Explanations:

Water/Sewer/Trash:

Gas:

Electricity:

Regular Maintenance and Supplies; Management Fee; Travel; Telephone:

Damage Repair:

Explanations:

Improvements:

Taxes:

Loan Payment:

Additional Expenses:

Question 7: Net Asset Income

a. Based on your answers to Questions 5 and 6, what do you anticipate will be the net income generated by the house in the coming year?

b. Based on your answer to 7.a., what will you count as net asset income for Robert Barker?

Question 8: Calculating Income and Rent

Using the charts following, calculate income and rent for the Barkers at this annual recertification.

Asset Income

1a. Family Member Name	FM #	1b. Asset Type	1c. C/I	Calculation for Asset Cash Value (mv - expenses)	1d. Cash Value of Asset	Calculation for Asset Income (mv x int/div)	1e. Actual Annual Asset Income
					$		$
					$		$
					$		$
					$		$
					$		$
					$		$
					$		$
					$		$
				TOTAL	$		$
If **1d. Total** is *greater than $5,000,* complete **Line 2.** and **Line 3.** If **1d. Total** is *less than or equal to $5,000,* enter $0 in **Line 2.**; complete **Line 3.**							
2. Imputed income from assets					HUD approved passbook rate (.02) x **1d.Total**		$
3. Total Asset Income					Greater of **Line 2.** or **1e. Total**		$

Annual Income

4a. Family Member Name	4b. FM #	Calculation	4c. Employment or Business	4d. Social Security, Pensions, etc.	4e. Public Assistance	4f. Other Income
4g. Total Income from each source			$	$	$	$
5. Total Income All Sources		Add all amounts on **Line 4g.** above:				$
6. Total Annual Income		Add **Line 5.** + Total Asset Income:				$

Adjusted Income

6. **Total Annual Income**: Carryover from **Line 6.** on **Annual Income** table			$
7. **Enter 3% of Total Annual Income** (Line 6. x .03)			
Dependent Allowance			
8. **Allowance for Dependents** (# of dependents ____ x $480)			$
Child Care Allowance			
9. **Child Care Allowance** (Line 8a. plus Line 8b.)			$
9a. Expense enabling family member to work (may not exceed $ earned by family member enabled to work)	$		
9b. Expense enabling family member to attend school and/or look for work	$		
Elderly/Disabled Household Allowance			
10. **Elderly/Disabled Household Allowance** ($400 or $0)			$
Disability Assistance Expenses			
11. **Enter total unreimbursed disability assistance expenses:**	$		
12. **Maximum allowable disability assistance expense** (Line 11. minus Line 7.) • If positive or zero, enter in **Box 12a.** • If negative, enter as positive number in **Box 12b.**	12a. $ 12b. $		
13. **Enter $ earned by family member enabled to work as a result of disability expenses**	$		
14. **Enter lower of Line 12a. or Line 13.** If Line **12a.** is blank or zero, enter zero	$		
Medical Expenses			
15. **Enter the total annual unreimbursed medical expenses for all family members of a disabled or elderly family**	$		
Medical/Disability Assistance Expenses Allowance			
16. **Enter the total of Line 14. and Line 15.**	$		
17. **Enter Line 12b.** If Line **12b.** is blank or zero, enter zero.	$		
18. **Medical/Disability Assistance Expense: Line 16.** minus **Line 17.** (but not less than zero)			
19. **Total Allowances: Total of Lines 8., 9., 10. and 18.**			
Total Adjusted Income			
20. **Adjusted Annual Income: Line 6.** minus **Line 19**			

Tenant Rent Calculation

1.	**Monthly Income** (Line 6. from Annual Income table ÷ 12)		$
2.	**Monthly Adjusted Income** (Line 20. from Adjusted Income table ÷ 12)		$
3.	**30% of Monthly Adjusted Income** (Line 2. x .30)		$
4.	**10% of Monthly Income** (Line 1. x .10)		$
5.	**Welfare Rent** (If applicable)		$
6.	**Minimum Rent** ($25 for Section 8 / $0 for PAC/PRAC)		$
7.	**Total Tenant Payment** (greater of Line 3., 4., 5., or 6.) ***Note***: May never exceed unit gross rent in Sec. 8 or PAC programs.		$
8.	**Utility Allowance** (UA)		$
9.	**Tenant Rent**: TTP – UA (Line 7. minus Line 8.)	**a. Tenant Rent:** If positive number, enter	$
		b. Utility Reimbursement: If negative number, enter as positive	$

Assistance Payment Calculation

1.	**Contract Rent:**	$
2.	**Utility Allowance** (same as Line 8. on Tenant Rent Calc. table)	$
3.	**Gross Rent** (Line 1. plus Line 2.)	$
4.	**TTP** (same as Line 7. on Tenant Rent Calc. table)	$
5.	**Assistance Payment:** (Line 3. minus Line 4.)	$
	5.a. Assistance Payment to Owner for Rent (Lesser of Line 5. or Line 1.)	$
	5.b. Assistance Payment to Owner for Utility Reimbursement (Line 5. minus Line 5.a.) ***Note***: Should equal **Line 9.b.** on **Tenant Rent Calc**. table	$

Trainer Notes: Approach to Case Study 3 and Presentation Materials

Purpose

- The primary focus of Case Study 3 is the treatment of revocable and nonrevocable trusts, both in terms of trusts as assets and income from trusts.
- A secondary goal is to reinforce information about assets disposed of for less than fair market value that was introduced in Module 4. In this case study the asset disposed of is real property.

Materials

- Part III materials discuss the following key concepts related to trusts:
  - Key parties related to trusts including: grantors, beneficiaries and trustees.
  - Differences between how revocable and nonrevocable trusts are handled.
- Part IV materials discuss assets disposed of for less than fair market value.
- Case Study 3 actually contains two separate family situations:
  - Case Study 3A: A Generous Grandmother involves the disposition of real estate and the establishment of a nonrevocable trust. Participants are required to complete a full HUD-50059 income and rent calculation.
  - Case Study 3B: A Cautious Arrangement involves the disposition of financial investments and the establishment of a revocable trust.
- Answers to the case study are found on page 5-132 in the Participant Manual.

Presentation vs. Review

- In a conference call format, participants are expected to have completed the case study in advance.
- In a classroom training setting, Parts III and IV should be presented as an interactive discussion and participants should complete the case study in class.

Tips and Cautions

- The two family situations should be addressed separately.
- Case Study 3A—note that although the trust itself is nonrevocable, the grantor (Wilma) continues to receive monthly income from the trust estimated at $200 per month. This is a situation where the trust grantor, Wilma, is a part of the same assisted household as the trust grantee, Eileen. When addressing assets and income for the family, the trust must be addressed both from the perspective of the grantor and the grantee.
- Note that for Case Study 3B two children in the scenario are minors. Question no. 3.b. asks participants to determine how the trust income might be different once the two minor family members reach age 21 and age 22. However, the rent calculation should be completed using the original scenario that the children are minors.
- Because participants must review multiple pieces of paper to collect information, less experienced participants may need assistance during the exercise. If the class includes a significant number of participants with little experience, consider having participants work in teams.
- As with the earlier case studies, keep in mind the primary objective of the case study exercises. We want to ensure that participants understand basic principles of trusts, both from the perspective of family member as grantor and family member as trustee. In addition, we want to ensure that participants understand how to recognize relevant trust information in documentation, and to make informed judgments on the value of trusts as assets, as well as income from trusts.

PART III TRUSTS AS ASSETS

What is a Trust?

- A trust is a legal arrangement in which one party (“creator/grantor”) transfers property (money, real estate, investments, personal property, etc.) to a second party (the “trustee”) to hold property for benefit of a third party (the “beneficiary”).

  Examples:

  Parents with minor children or adult children with disabilities frequently establish trusts that specify a trustee to handle financial matters for children in the case of the parents' death.

  Settlements of court cases or insurance claims may be set up as a trust specifically for the benefit of an injured or disabled person.

- A nonrevocable trust is one that, once the creator establishes it, cannot be changed or revoked (ended)
  - The creator does not have access to the funds
- A revocable trust is one in which the creator may change the terms of the trust or revoke the trust.
  - In this case, the creator is considered to have access to the funds
- An assisted family member may be related to a trust in one of three ways:
  - A family member may be the trustee
  - A family member may be the creator (grantor) of the trust
  - A family member may be the beneficiary of the trust

Notes

When a Family Member is the Trustee

- If the family member is a trustee, the family member holds or administers the trust for another person.
  - The value of the trust is not considered as an asset to the trustee because the trust does not belong to the trustee.
  - It does not matter whether the trust is revocable or nonrevocable because the trustee has no access to the trust.
- The trustee may receive compensation for administering the trust.
  - In this case the compensation the trustee receives would be counted as income to the trustee.

When a Family Member is the Creator of a Trust

- If the family member is the creator of the trust, the family member has allocated some of his or her resources to another person through a trust.
- Trust creator and trust beneficiary may be members of same assisted family.
- If the creator is a member of the assisted family, the owner must ask a fundamental question:

Notes

Is the trust revocable?

- If “Yes”, the value of the asset is considered an asset of the family member and the cash value would be counted in net family assets.
- If “No”, the family member no longer has access to the trust and the value of the asset is no longer considered an asset of the family member.
- An asset that is placed in a nonrevocable trust by a family member would be considered an asset disposed of for less than fair market value, because the family member can no longer get at the asset.
- An asset that is placed in a revocable trust by a family member is still accessible to the family and would not be considered disposed of for less than fair market value.

• Owner must also ask:

Does the family member receive any income from the trust?

- If “Yes”, this income would be included in annual income.

  Example:

  A grandparent has established a nonrevocable trust that sets aside $100,000 for the care of a grandchild upon the grandparent's death. But, while the grandparent is alive the income from the trust (interest on the trust account) is received by the grand parent.

  In this case, the value of the trust would be counted as an asset disposed of for less than fair market value, and the interest received by the grandparent would be counted as income.

Notes

When a Family Member is the Beneficiary of a Trust

- The family member may be the beneficiary of a trust created by another individual.
- Trust beneficiary and trust creator may be members of the same assisted family.
- If a member of the assisted family is the beneficiary of the trust, the owner must ask two fundamental questions:

  Does the family member, as beneficiary, have access to any of the principal balance of the asset?

  - If any family member has right to withdraw trust funds, the trust is considered an asset like any other asset. Cash value of the principal is added to total net family assets.
  - Some trusts provide that the beneficiary may receive a lump sum amount at a specified time (e.g., reaching the age of 21, at the death of the grantor, upon completion of college, etc.).
  - A lump sum payment is considered a lump sum addition to assets.

  Does the family member have access to any income from the asset?

  - Some trusts provide that the beneficiary receive periodic payments from the trust.
  - Periodic payments would be considered regular contributions and would be counted as income.

Special Needs Trust

- Special Needs Trusts are created under some state laws, usually by family members for disabled persons unable to make financial decisions for themselves.
- Principal balance in the trust generally is not accessible to the beneficiary; and so would not be counted as part of net family assets for beneficiary.
- Regular income paid from the trust to the beneficiary is counted as annual income.

PART IV ASSETS DISPOSED OF FOR LESS THAN FAIR MARKET VALUE

- Assets disposed of for less than fair market value were introduced in Module 4. This is a refresher of that information.
- Assets that were disposed of for less than fair market value in the two years prior to the effective date of the certification/recertification are counted as current assets owned by the family.
- However, there are a few exceptions to this rule:
  - Exception: Assets disposed of as part of a separation or divorce settlement are not counted
  - Exception: Assets disposed of as a result of foreclosure or bankruptcy sale are not counted
  - Exception: This rule applies only when the fair market value of all assets disposed of in the preceding two years exceeds the gross amount received as compensation for those assets by more than $1,000.

    Example:

    During the past two years, the Nusbaum family made 3 different charitable donations of $300, $150 and $200.

    Total disposed of for less than Fair Market Value:

    - $300 + $150 + $200 = $650
    - $1000 > $650, so no asset counted

    Example:

    Mrs. Johnson withdraws $10,000 from her savings account and gave it to her son to help him make a down payment on a house for his family. Since the amount given is more than $1,000 the owner continues to count the $10,000 as an asset for Mrs. Johnson for two years from the date the asset was “disposed of.”

Notes

- As discussed in Part III, assets placed in nonrevocable trusts are considered as "assets disposed of for less than fair market value"
    - One exception would be where the assets placed in the nonrevocable trust were received through settlements or judgments.
- Applicants/participants must declare (i.e., self-certify) at each income certification and recertification whether or not any assets have been disposed of for less than fair market value.
    - The owner should develop a certification form for this purpose.
    - The owner should make additional verification efforts only if the self-certification is inconsistent with other information provided by the family.
- The amount counted as an asset disposed of for less than fair market value is the difference between the cash value of the asset and the amount actually received in compensation for the asset.

Example:

Mrs. Franklin cashed in a $10,000 certificate of deposit. She paid an interest penalty of $386.

With the money, she made repairs to her car of $1,800 and spent about $200 on groceries. The remainder she gave to her sister (who does not live with her) to prevent foreclosure on her sister's house.

The cash value of the asset disposed of for less than fair market value would be calculated as follows:

$10,000	CD Market Value
– $386	Fees/penalties
– $2,000	Spent on auto and groceries
$7,614	Disposed of for less than Fair Market Value (gave to sister)

Notes

- When the two-year period expires the disposed of asset is no longer counted. The family may request an interim recertification to remove the disposed of asset if the two year period expires between recertifications.

NOTES

CASE STUDY 3A: A GENEROUS GRANDMOTHER

Background

Today is July 10, 2005. You are working on the annual recertification for Betty White (head, age 41), her daughter Eileen (daughter, age 10), and Betty's mother Wilma Watson (other adult, age 75). The family lives in a three bedroom unit with a contract rent of $1,000 and a utility allowance of $82. The recertification is to be effective September 1, 2005.

Betty works full-time at Sunshine Cleaners, making $8.50/hour. You have received third-party verification (not included in this case study) directly from Betty's employer that substantiates her income.

Prior to moving in with Betty, Wilma lived alone in her single-family home that she owned for many years. Typical of many elderly people she was "house rich" but "income poor." Her only sources of income are Social Security ($900/month) and a small pension ($350/month). You have obtained third-party verification (not included in this case study) for both of these amounts.

A few months ago, it became too hard for her to manage such a big house, not to mention getting around in the house, going up and down stairs, and so forth. So, Wilma decided to sell the house to her son Frank and move in with Betty and Eileen.

Wilma's house had appreciated significantly over the years that she lived there. However, Wilma wanted to give Frank a "good deal" on the house because his family is struggling, so she sold the house to Frank for $50,000. She used $20,000 of the sales proceeds as follows:

- $12,000 Paid off a small personal loan
- $1,000 Paid moving expenses to move in with Betty and Eileen
- $7,000 Deposited into her savings account, earning 1.75% interest

The remaining $30,000 she placed in a nonrevocable trust for her granddaughter Eileen. Wilma hopes that Eileen will use the money for college and structured the trust so that the money will only be available to Eileen if she is a full-time student. The terms of the trust specify that, once Eileen turns age 18, the trust will make equal payments directly to Eileen, four times a year for five years, provided that Eileen can demonstrate full-time enrollment in college. Upon graduation from college, Eileen will receive a lump-sum payment of the balance remaining (if any) in the trust.

For as long as she lives, Wilma will receive the income from the trust, currently estimated at $200/month.

On the pages that follow, you will find:

- Excerpts from the recertification form completed by the Betty and her family
- Copy of a recent appraisal of the house, right before Wilma sold the house to Frank
- Copy of a Quit Claim Deed, transferring ownership of the house to Frank.

Review the information and answer the questions that follow.

HOUSEHOLD COMPOSITION AND CHARACTERISTICS

List all family members who will be living in the unit. Include additional information listed.

Mem. No.	Full Name	Relation to Head	Birth Date	Sex	SSN	Occupation or School	C/EI* Y/N	Dis* Y/N	FTS* Y/N
1	Betty White	Head	8/11/63	F	123-45-6789	Cleaners	Y	N	N
2	Eileen White	Dau.	9/12/94	F	123-45-6788	School	Y	N	Y
3	Wilma Watson	Other.	10/1/29	F	123-45-6787	None	Y	N	N
1	Betty White	Head	8/11/63	F	123-45-6789	Cleaners	Y	N	N

EMPLOYMENT INCOME

Is any member of the family employed (including self-employed), or expected to be employed in the next 12 months?

☑ Yes ❑ No

If "Yes", complete table below.

Mem. No.	Employer Name Address Phone No.	Regular Income Rate (income per hour, per week, per month, etc.)	Other income (overtime, bonuses, tips, commissions, etc.)	Estimated Gross Annual Income
1	Sunshine Cleaners	\$8.50/hour x 40 hours/week x 52 weeks/year	None	\$15,000 or so

OTHER INCOME

Complete the "Other Income" chart (here's an excerpt from that chart):

Income Item	Yes	No	Family Member
Social Security	☑	❑	Wilma
Pension / Retirement	☑	❑	Wilma
Other, Explain: Trust Income	☑	❑	Wilma

Where you checked "Yes" for any items, provide additional detail in the chart below.

Mem. No.	Other Income Item (from chart)	Income Provider Name Account No.	Other Income Rate (Income per hour, per week, per month, etc.)	Estimated Gross Annual Income
3	Social Security	SSA	\$900/month	\$10,800
3	Pension	ACME Manufacturing	\$350/month	\$4,200
3	Trust	Trust	\$200/month	\$2,400

ASSETS AND ASSET INCOME

Complete the "Asset" chart (here's an excerpt from that chart):

Asset	Yes	No	Family Member
Checking Account	☑	❑	Betty
Savings Account	☑	❑	Wilma

Where you checked "Yes" for any asset, provide additional detail in the chart below.

Mem. No.	Asset Type (from chart)	Asset Name Asset Provider Account No.	Current Value of Asset	Estimated Gross Annual Income from Asset
1	Checking	One National Bank	$500	None
3	Savings	One National Bank	$8,500	$149 (1.75%)

Have any adult family members sold or disposed of any business or asset in the past 2 years? ☑ **Yes** **No**

If "Yes," explain:

Wilma sold home to son Frank in May, 2005

See attached Quit Claim Deed

CHILD CARE

Do you employ the services of a Care Provider for a child 12 years old or younger? ❑ **Yes** ☑ **No**

DISABILITY ASSISTANCE EXPENSES

Do you employ the services of a Care Attendant, or do you pay for any equipment, for any household member(s) with disabilities, in order to permit any family member to work? ❑ **Yes** ☑ **No**

MEDICAL EXPENSES

The family head of household and/or the spouse of the head of household are:
- **a) 62 years of age or older;**
- **b) handicapped; or**
- **c) disabled?**

☑ **Yes** ❑ **No**

If "Yes", indicate estimated costs to the family for medical expenses (for example - medications, medical/dental treatments, medical insurance, prescribed medical appliances, etc.) which are not reimbursed by an outside source.)

Costs per month	$	100
Other costs not paid on monthly basis	$	0

PROPERTY APPRAISAL

DATE:	May 1, 2005
APPRAISAL REQUESTED BY:	Wilma Watson
APPRAISAL CONDUCTED BY:	A. P. Razor, CA, SLA
PROPERTY ID:	Parcel 76767, Lot 111
LOCATION:	615 Aloha Street Emerald City, ST
DESCRIPTION:	Single family, 2-story dwelling 2,000 square feet Located on 1 acre lot Northwest corner, intersection of Aloha and Magnolia streets
OWNER(S) OF RECORD:	Wilma Watson
EST. CURRENT MARKET VALUE:	$80,000
EST. SALES CHARGE:	$4,000

A. P. Razor — May 1, 2005

SIGNATURE — DATE

Quit Claim Deed

THIS QUITCLAIM DEED, Executed this 1st day of June, 2005,

by first party: Wilma Watson

to second party: Frank Watson

WITNESSETH, That the said first party, for good consideration and for the sum of Fifty Thousand dollars ($50,000) paid by the said second party, the receipt whereof is hereby acknowledged, does hereby remise, release and quitclaim unto the said second party forever, all the right, title, interest and claim which the said first party has in and to the following described parcel of land, and improvements and appurtenances thereto in the County of Emerald, State of State, to wit:

Parcel 76767, Lot 111
615 Aloha Street
Emerald City, ST

IN WITNESS WHEREOF, The said first party has signed and sealed these presents the day and year first above written.

Signed, sealed and delivered in presence of:

Wilma Watson	Emmanuel Esteban
First Party	Witness
Frank Watson	Kelly Kimball
Second Party	Witness

STATE OF State.
COUNTY OF Emerald.

On June 1st, 2005 before me, Nota Terry, Notary Public, personally appeared Wilma Watson and Fred Watson, personally known to me (or proved to me on the basis of satisfactory evidence) to be the person(s) whose name(s) is/are subscribed to the within instrument and acknowledged to me that he/she/they executed the same in his/her/their authorized capacity(ies), and that by his/her/their signature(s) on the instrument the person(s), or the entity upon behalf of which the person(s) acted, executed the instrument.

WITNESS my hand and official seal.

Nota Terry
Signature

Nota Terry
Commission 411114
Notary Public - State
Emerald County
My Commission Expires:
01/01/2007

Question 1

What are Wilma's assets and what are the values of those assets?

Question 2

Using the information you have, and assuming adequate verification of Betty's employment income and checking account, as well as Wilma's savings account, social security income and pension income, compute income and rent for the family on the following pages.

Asset Income

1a. Family Member Name	FM #	1b. Asset Type	1c. C/I	Calculation for Asset Cash Value (mv - expenses)	1d. Cash Value of Asset	Calculation for Asset Income (mv x int/div)	1e. Actual Annual Asset Income
				TOTAL	$		$
If **1d. Total** is *greater than $5,000,* complete **Line 2.** and **Line 3.** If **1d. Total** is *less than or equal to $5,000,* enter $0 in **Line 2.**; complete **Line 3.**							
2. Imputed income from assets				HUD approved passbook rate (.02) x **1d.Total**			$
3. Total Asset Income				Greater of **Line 2.** or **1e. Total**			$

Annual Income

4a. Family Member Name	4b. FM #	Calculation	4c. Employment or Business	4d. Social Security, Pensions, etc.	4e. Public Assistance	4f. Other Income
4g.Total Income from each source			$	$	$	$
5. Total Income All Sources					Add all amounts on **Line 4g.** above:	$
6. Total Annual Income					Add **Line 5.** + Total Asset Income:	$

Adjusted Income

6. **Total Annual Income**: Carryover from **Line 6.** on **Annual Income** table			$
7. **Enter 3% of Total Annual Income** (Line 6. x .03)			
Dependent Allowance			
8. **Allowance for Dependents** (# of dependents ____ x $480)			$
Child Care Allowance			
9. **Child Care Allowance** (Line 8a. plus Line 8b.)			$
9a. Expense enabling family member to work (may not exceed $ earned by family member enabled to work)	$		
9b. Expense enabling family member to attend school and/or look for work	$		
Elderly/Disabled Household Allowance			
10. Elderly/Disabled Household Allowance ($400 or $0)			$
Disability Assistance Expenses			
11. Enter total unreimbursed disability assistance expenses:	$		
12. Maximum allowable disability assistance expense (Line 11. minus Line 7.) • If positive or zero, enter in **Box 12a.** • If negative, enter as positive number in **Box 12b.**	12a. 12b.	$ $	
13. Enter $ earned by family member enabled to work as a result of disability expenses	$		
14. Enter lower of Line 12a. or Line 13. If Line **12a.** is blank or zero, enter zero	$		
Medical Expenses			
15. Enter the total annual unreimbursed medical expenses for all family members of a disabled or elderly family	$		
Medical/Disability Assistance Expenses Allowance			
16. Enter the total of Line 14. and Line 15.	$		
17. Enter Line 12b. If Line **12b.** is blank or zero, enter zero.	$		
18. Medical/Disability Assistance Expense: Line 16. minus **Line 17.** (but not less than zero)			
19. Total Allowances: Total of Lines 8., 9., 10. and 18.			
Total Adjusted Income			
20. Adjusted Annual Income: Line 6. minus **Line 19**			

Tenant Rent Calculation

1.	**Monthly Income** (Line 6. from Annual Income table ÷ 12)		$
2.	**Monthly Adjusted Income** (Line 20. from Adjusted Income table ÷ 12)		$
3.	**30% of Monthly Adjusted Income** (Line 2. x .30)		$
4.	**10% of Monthly Income** (Line 1. x .10)		$
5.	**Welfare Rent** (If applicable)		$
6.	**Minimum Rent** ($25 for Section 8 / $0 for PAC/PRAC)		$
7.	**Total Tenant Payment** (greater of Line 3., 4., 5., or 6.) ***Note***: May never exceed unit gross rent in Sec. 8 or PAC programs.		$
8.	**Utility Allowance** (UA)		$
9.	**Tenant Rent**: TTP – UA (Line 7. minus Line 8.)	**a. Tenant Rent:** If positive number, enter	$
		b. Utility Reimbursement: If negative number, enter as positive	$

Assistance Payment Calculation

1.	**Contract Rent:**	$
2.	**Utility Allowance** (same as Line 8. on Tenant Rent Calc. table)	$
3.	**Gross Rent** (Line 1. plus Line 2.)	$
4.	**TTP** (same as Line 7. on Tenant Rent Calc. table)	$
5.	**Assistance Payment:** (Line 3. minus Line 4.)	$
	5.a. Assistance Payment to Owner for Rent (Lesser of Line 5. or Line 1.)	$
	5.b. Assistance Payment to Owner for Utility Reimbursement (Line 5. minus Line 5.a.) ***Note***: Should equal **Line 9.b.** on **Tenant Rent Calc**. table	$

Question 3

Eileen will turn age 18 on September 12, 2012.

a. Under what circumstances would Eileen become and remain a beneficiary of the trust? What additional information might you need about the trust in order to make this determination?

b. Assuming that Eileen becomes a beneficiary of the trust when she turns age 18 and assuming that she continues to live in assisted housing; will you ***exclude*** the trust income for Eileen? Explain your answer below.

- Yes
- No

Explanation:

CASE STUDY 3B: A CAUTIOUS ARRANGEMENT

Background

Today is June 10, 2005. You are working on the annual recertification for Margarita Katz and her two children Alicia (15) and Leonard (16).

The family lives in a three bedroom unit with a contract rent of $1,100 and a utility allowance of $90. The recertification is to be effective August 1, 2005.

Margarita is self-employed, working part-time cleaning homes. She works year-round, but usually only 15-20 days per month. Her rate is $8.00/hour. She reports that most people pay her with a check, but many simply pay cash. Margarita’s husband Jonathan died last year. She receives a small pension from Jonathan’s employer, $300/month. You verify the pension directly with the provider (verification not included in this case study).

Margarita also has a checking account with a balance of $5,500, earning no interest.

Margarita’s in-laws, Fred and Ethel Katz, also live in the development. Fred and Ethel are concerned about their son's children and want to provide for them. However, they have never been on good terms with Margarita.

Fred and Ethel have quite a few assets, primarily stocks and mutual funds. They decide to liquidate some of their assets and establish a revocable trust with a current principal balance of $100,000. The trust specifies that Margarita will receive a $500/month for the care of the children until she remarries or until the children reach 21 years of age.

When Leonard turns 21, he will receive $250/month and the amount paid to Margarita will be reduced to $250. When Alicia turns 21, she will receive $250/month and the amount paid to Margarita will be reduced to $0.

Although the grandparents have every intention of maintaining this trust, they made it revocable in case they need these funds for their own care.

Question 1

a. The law defines a small business concern as “one that is independently owned and operated and which is not dominant in its field of operation.” In essence, Margarita is operating a small business with herself as the sole employee.
   - What would you like to see from Margarita to establish her self-employment income?

b. Margarita is able to provide you with cancelled checks showing some work done over the past couple of months. She states that much of her work during this time was paid with cash, and she cannot produce any cancelled checks for these jobs. She is able to provide you with an appointment calendar, dating back to the beginning of the year, where she records all of her scheduled jobs. She is also able to provide you with bank statements for the last 3 months, showing a number of deposits, though Margarita admits that she mixes work cash deposits with personal cash deposits and withdrawals all of the time. She claims to have not yet filed her taxes for last year, and cannot find any tax returns for previous years.

By going through the calendar with her, you are able to determine that Maria worked an average of 140 hours each month for the past six months, dating back to January 1st. The checks that she produces are consistent with a rate of $8.00/hour. The bank statement deposits do not provide a clear record of cash deposits consistent with hours worked.

Margarita states that she has no expenses for supplies and equipment. These are all provided by her clients. Margarita says she is willing to sign a certification that the information she has provided is accurate.

- How would you approach Margarita's work income and what figure would you use for net income?

Question 2

How much of the $100,000 principal of the trust will you count as an asset for the following individuals? Explain your answers:

Margarita:	$	
Leonard:	$	
Alicia:	$	

Explanation

Question 3

a. How much of the $500/month that comes from the trust will you count as income for the following individuals? Explain your answers:

Margarita:	$	
Leonard:	$	
Alicia:	$	

Explanation

b. Assume that both Leonard is now age 22 and Alicia is age 21. Alicia is a full-time student and Leonard works part-time. Both still lives at home with Margarita. What will you count as monthly income from the trusts for the following individuals? Explain your answers.

Margarita:	$	
Leonard:	$	
Alicia:	$	

Explanation

Question 4

Assume that you are conducting an annual recertification for Fred and Ethel Katz.

a. How much of the $100,000 principal of the trust will you count as an asset for them? Explain your answer below. $

Explanation:

b. Given that Fred and Ethel liquidated other assets to set up the trust, how much of the trust will you consider an asset disposed of for less than fair market value? Explain your answer below. $

Explanation:

c. How much of the $500/month that comes from the trust will you count as income for Fred and Ethel? Explain your answer below. $

Explanation:

Question 5

Using the information you have, and assuming adequate verification of Margarita's checking account, pension income and trust, compute income and rent for the family on the following pages.

Asset Income

1a. Family Member Name	FM #	1b. Asset Type	1c. C/I	Calculation for Asset Cash Value (mv - expenses)	1d. Cash Value of Asset	Calculation for Asset Income (mv x int/div)	1e. Actual Annual Asset Income
				TOTAL	$		$
If **1d. Total** is *greater than $5,000,* complete **Line 2.** and **Line 3.** If **1d. Total** is *less than or equal to $5,000,* enter $0 in **Line 2.**; complete **Line 3.**							
2. Imputed income from assets						HUD approved passbook rate (.02) x **1d.Total**	$
3. Total Asset Income					Greater of **Line 2.** or **1e. Total**		$

Annual Income

4a. Family Member Name	4b. FM #	Calculation	4c. Employment or Business	4d. Social Security, Pensions, etc.	4e. Public Assistance	4f. Other Income
4g. Total Income from each source			$	$	$	$
5. Total Income All Sources					Add all amounts on **Line 4g.** above:	$
6. Total Annual Income					Add **Line 5.** + Total Asset Income:	$

Adjusted Income

6. Total Annual Income: Carryover from **Line 6.** on **Annual Income** table		$
7. Enter 3% of Total Annual Income (Line 6. x .03)		
Dependent Allowance		
8. Allowance for Dependents (# of dependents ____ x $480)		$
Child Care Allowance		
9. Child Care Allowance (Line 8a. plus Line 8b.)		$
9a. Expense enabling family member to work (may not exceed $ earned by family member enabled to work)	$	
9b. Expense enabling family member to attend school and/or look for work	$	
Elderly/Disabled Household Allowance		
10. Elderly/Disabled Household Allowance ($400 or $0)		$
Disability Assistance Expenses		
11. Enter total unreimbursed disability assistance expenses:	$	
12. Maximum allowable disability assistance expense (Line 11. minus Line 7.) • If positive or zero, enter in **Box 12a.** • If negative, enter as positive number in **Box 12b.**	12a. $ 12b. $	
13. Enter $ earned by family member enabled to work as a result of disability expenses	$	
14. Enter lower of Line 12a. or Line 13. If Line **12a.** is blank or zero, enter zero	$	
Medical Expenses		
15. Enter the total annual unreimbursed medical expenses for all family members of a disabled or elderly family	$	
Medical/Disability Assistance Expenses Allowance		
16. Enter the total of Line 14. and Line 15.	$	
17. Enter Line 12b. If Line **12b.** is blank or zero, enter zero.	$	
18. Medical/Disability Assistance Expense: Line 16. minus **Line 17.** (but not less than zero)		
19. Total Allowances: Total of Lines 8., 9., 10. and 18.		
Total Adjusted Income		
20. Adjusted Annual Income: Line 6. minus **Line 19**		

Tenant Rent Calculation

1.	**Monthly Income** (Line 6. from Annual Income table ÷ 12)		$
2.	**Monthly Adjusted Income** (Line 20. from Adjusted Income table ÷ 12)		$
3.	**30% of Monthly Adjusted Income** (Line 2. x .30)		$
4.	**10% of Monthly Income** (Line 1. x .10)		$
5.	**Welfare Rent** (If applicable)		$
6.	**Minimum Rent** ($25 for Section 8 / $0 for PAC/PRAC)		$
7.	**Total Tenant Payment** (greater of Line 3., 4., 5., or 6.) ***Note***: May never exceed unit gross rent in Sec. 8 or PAC programs.		$
8.	**Utility Allowance** (UA)		$
9.	**Tenant Rent**: TTP – UA (Line 7. minus Line 8.)	**a. Tenant Rent:** If positive number, enter	$
		b. Utility Reimbursement: If negative number, enter as positive	$

Assistance Payment Calculation

1.	**Contract Rent:**	$
2.	**Utility Allowance** (same as Line 8. on Tenant Rent Calc. table)	$
3.	**Gross Rent** (Line 1. plus Line 2.)	$
4.	**TTP** (same as Line 7. on Tenant Rent Calc. table)	$
5.	**Assistance Payment:** (Line 3. minus Line 4.)	$
5.a.	**Assistance Payment to Owner for Rent** (Lesser of Line 5. or Line 1.)	$
5.b.	**Assistance Payment to Owner for Utility Reimbursement** (Line 5. minus Line 5.a.) ***Note***: Should equal **Line 9.b.** on **Tenant Rent Calc**. table	$

Trainer Notes: Approach to Case Study 4 and Presentation Materials

Purpose

- Case Study 4 gives participants an opportunity to practice working with several new concepts discussed in this Module as follows:
  - Mortgages held by family members
  - Joint ownership of a business with someone outside the assisted family.
  - Calculating self-employment income when a family member does not take a regular salary from the business.
  - Earned income tax credits

Materials

- Part V materials discuss two key income and rent issues not covered elsewhere in the module:
  - Mortgages and Deeds of Trust held by family members
  - Earned Income Tax Credits (EITC) received by certain categories of working family members
- Case Study 4 is actually three separate “mini” case studies:
  - Case Study 4A: The Curly-Q Salon – Under New Management revisits the Curly-Q Salon from case study 1. In this case study, ownership of the business is shared by a tenant and an unassisted individual outside the family.
  - Case Study 4B: A Clean Business offers another small business example, this one with both the owner and the only employee as members of the same assisted family.
  - Case Study 4C: Earned Income Tax Credit (EITC) offers a scenario where the assisted individual is receiving and has received EITC.
- Answers to the case study are found on page 5-144 in the Participant Manual.

Presentation vs. Review

- In a conference call format, participants are expected to have completed the case study in advance.
- In a classroom training setting, Part V should be presented as an interactive discussion and participants should complete the case study in class.

Tips and Cautions

- You may need to have a brief review of the basic circumstances of the Curly-Q salon from Case Study 1, before proceeding with Case Study 4A. In addition, you should ensure that the participants are in general agreement about the results and amounts from Case Study 1. Case Study 4A adds a wrinkle to the Case Study 1 scenario, but primarily relies on the Case Study 1 conclusions as a starting point.
- Because Case Study 1 is a fairly detailed look at business income and expenses, Case Study 4B does not revisit all of these issues again. The case study illustrates that salaries and profits taken from the business are expenses to the business and may reduce gross business income, on the one hand, but are also counted as annual income to the family members drawing the salary or taking the profits, on the other hand.
- Case Study 4C offers two different variations on EITC – both from the perspective of EITC payments received as a separate refund payment, after filing of taxes, and from the perspective of EITC received as regular advanced “payments”, by reducing the regular withholdings from an individual’s earned pay, in the amount of the EITC. Emphasize the latter point about EITC payments – they may be easily missed when they are provided as a reduction of regular withholdings and may lead to inadvertent over-counting of an individual’s gross income.

PART V OTHER INCOME AND ASSET ISSUES

4350.3 REV-1, Par. 5-7G5., Exhibit 5-2

Mortgage or Deed of Trust as an Asset

- When an individual sells a piece of real estate, the individual (seller) may loan money to the purchaser through a mortgage or deed of trust.
  - Also known as a “contract sale”
  - Often referred to as the seller “holding the paper” on the property
- Any mortgage or deed of trust held by a family member (seller) is considered an asset for that family member.
  - This could include situations where an assisted family member owned a piece of property in the past, sold the property and now holds the mortgage or deed of trust.
- The family member (seller) will usually receive an annual payment that includes both payment on the principal and payment on the interest
  - The payment needs to be separated into principal and interest portions
  - The *interest* portion of the payment is counted as income.
  - The *principal* portion of the payment is not counted as income.
- The value of the asset is the unpaid *principal* balance of the mortgage or deed of trust.
  - Each year, the unpaid principal balance will decline as more principal is paid off.

Notes

Earned Income Tax Credit (EITC)

4350.3 REV-1, Exhibit 5-1

- Federal regulations explicitly exclude Earned Income Tax Credit (EITC) refund payments from annual income.
- To qualify for EITC, individuals must meet various criteria established by the IRS (detailed in IRS publication 596). Key criteria include:
  - Adjusted gross income must be below certain thresholds
  - Must have a valid SSN
  - Must be a U.S. citizen or resident alien all year
  - Investment income must be below certain threshold
  - Must have earned income and this earned income must also be below certain thresholds
  - Additional criteria are dependent upon whether the individual has children, the number and ages of children, among other criteria
- EITC payments are typically requested by filing an annual tax return. The EITC payment is received along with any other tax refund for which the individual qualifies.
- Individuals also may elect to receive "advance payments" of the expected EITC as part of a regular paycheck from an employer.
  - Employer payroll records <u>should</u> show the EITC payment as an addition to ***net*** income.
  - Therefore owners should be able to count as income the gross income reported by the employer (because the EITC is not included in the gross income).
  - However, owners should review the employer's documentation to ensure that the employer has not reported a gross income amount that includes the EITC payments.

Case Study 4A: The Curly-Q Salon – Under New Management

Return to the Curly-Q Salon, discussed in Case Study 1, and assume that Jackie and Connie are now the co-owners of the business. Because Jackie put in most of the work in building up the business and continues to manage the business day-to-day, they consider their ownership arrangement to be 60% Jackie's business and 40% Connie's business.

Question 1

How would this change your assessment of the net business income to include in Jackie's annual income?

Question 2

Assuming the same calculations of gross business income, business expenses and net business income for the coming year, how much business income would you include in Jackie's annual income?

$		Business income

Question 3

a. Jackie tells you that rather than reinvesting the net income in the business, both she and Connie withdrew the money and used it to host a big party for friends, family and clients to celebrate Curly-Q's success in its first year. So, according to Jackie, the actual net income for Curly-Q was zero.

- Do you count the $1,445 that Jackie withdrew in annual income? Explain your answer.
  - Yes
  - No

Explanation:

b. How might your answer be different if Jackie says that the cost of the party was charged to Curly-Q as an advertising expense?

Explanation:

Question 4

Suppose that Jackie and Connie had miscalculated slightly and withdrew $2,700 for their party, leaving them with a net business loss of $292. Jackie's portion of this loss is $175 ($292 x .60). Can you reduce Jackie's annual income from other sources by this amount? Explain your answer.

a. Yes
b. No

Explanation:

CASE STUDY 4B: A CLEAN BUSINESS

Lance Clean owns a house cleaning business, which just got started this past year. Lance invested $1,500 to get the business going. The gross income for the business was $32,000.

Lance does not receive a regular salary from the business. His intent is to take a profit each quarter – if there is one. Last year Lance did not take any profits from the business, in an effort to get the business going. However, Lance believes his business is improving and he feels he will be safe in taking $2,000 in profits each quarter for the coming year.

Lance employs his 22 year old son Terry Clean, who also lives with the family. Terry works 40 hours a week, and earns $5.50 per hour. This is not expected to change over the coming year.

The business's other expenses in the past year included $10,000 for insurance, equipment, supplies, advertising, and the cost of a part-time bookkeeper. Again, Lance expects these expenses to remain the same for the coming year.

The family has no other sources of income.

Lance provides you with the following breakdown of gross business income for the past year.

Month	Gross Income		
1	$0		
2	$500		
3	$2,000		
4	$2,500		
5	$3,000		
6	$3,100		
6-month Total:		**$11,100**	
6-month Average:			**$1,850/month**
7	$3,000		
8	$3,300		
9	$3,100		
10	$4,000		
11	$3,700		
12	$3,800		
6-month Total:		**$20,900**	
6-month Average:			**$3,483/month**
Annual Total:		**$32,000**	
Annual Average:			**$2,667/month**

Question 1

Based on the information provided, anticipate net business income for the Clean business for the coming year using two approaches. For each approach, explain your answer:

a. **Net Business Income** based on income information from the *entire 12-month period of the previous year*

Explanation:

b. **Net Business Income** based on income information from the *most recent 6-month period of the previous year*

Explanation:

Question 2

From the two methods used in your answer to Question 1, choose the method that seems the most reasonable to you and compute the family's annual income for the coming year. Explain your approach.

Family's annual income for the coming year: | |

Explanation:

CASE STUDY 4C: EARNED INCOME TAX CREDIT (EITC)

Question 1

At the annual recertification, Kyle reports that he recently received an EITC check for $2,000 and he reports it to you as lump sum income. Kyle also reports that he took his EITC check and opened a new savings account. In the savings account, the money will earn 2% interest over the coming year.

- How much (if any) will you count as income for Kyle, how much (if any) will you count as Kyle's assets and how much (if any) will you count as income from assets? Explain your answers.

Income	$	
Assets	$	
Income from Assets	$	

Explanation:

Question 2

At the next annual recertification, no mention is made of EITC. However, at the annual recertification for the following year, Kyle reports that he has been receiving an advanced payment of EITC in his weekly paycheck for the past year. Your employment verification form used at the prior recertification did not ask the employer about EITC, nor did the employer offer this information.

- How would you handle this information at this point?

MODULE 5 – POST-TRAINING SELF TEST

Note: This test is provided as a learning tool. The post-training self test is designed to measure your level of knowledge after studying this module. Answer the questions as best you can, (without looking at the training materials). Any questions you miss represent areas you should review in the training materials and Handbook 4350.3 REV-1.

Answers to Post-training Self Test are in Attachment F at the end of this module.

1. Jake and Roberta (and their 3 children) live in your development. Roberta recently inherited an interest in a residential property owned by her grandmother along with her brother and two cousins. Identify at least four things you need to know in order to determine how this inheritance will affect the family's income and rent determinations.

a.
b.
c.
d.

2. Which of the following amounts would you consider a legitimate business expense for Mr. Senoj, a handyman who works out of his apartment in your assisted development (assume that all costs are “reasonable”)? For each “no” or “maybe” answer, explain your answer and what else you might need to know.

	Yes	No	Maybe
a. $500 paid to his accountant to prepare his income tax.			
b. Interest on a credit card he uses to buy business supplies.			
c. Tickets to a professional football game given as a bonus to his assistant.			
d. The second telephone line installed in the apartment.			
e. The amount of depreciation on his truck as indicated by comparing this year's “blue book” value with last year's.			
f. The $250 a customer refused to pay for work he had completed.			

Explanations:

3. Bill, Betty and their son Benny live in assisted housing. As a result of a traffic accident Benny is disabled. The driver’s insurance company set up a nonrevocable trust to cover Benny’s medical and care expenses.
   - How should the trust be handled in rent calculations?

4. Mrs. Gimble has recently moved into an assisted development because she can no longer take care of her single-family home. She intends to sell the house but is currently renting the house for $800/month until she does.

   Mr. Gimble (now deceased) bought the house for $40,000 in 1980. The house is now valued at $75,000. A few years ago Mrs. Gimble took out a $10,000 second mortgage to make some repairs to the house. Then, two years ago, she took out another $10,000 loan against the house to help her grandson with college expenses.

   She provides documents that verify the following information about her mortgages and loans:

Loan	Original Balance	Current Balance
1 (original mortgage)	$37,000	$4,800
2 (second mortgage)	$10,000	$5,200
3 (loan)	$10,000	$8,000

   She provides documents that verify the following information about the rental of the house:

Rent Received last year:	$8,000
Taxes:	$1,200
Maintenance:	$1,000

   a. What asset amount would you include in rent calculations?

   b. What gross income from asset would you anticipate related to the house?

   c. What expense items would you deduct from gross income to get net income from this asset?

5. Mary C. has been living with her son, but now that a unit has become available she is moving into an assisted development. Because her apartment is small and she wants to thank her son for his help she gives him the following:
   - Some of her old furniture worth $5,000
   - Her automobile worth $4,000
   - 3,000 in cash
   - How will you treat these gifts when you anticipate Mary's income for the coming year?

6. Ms. Jackson is unemployed and receiving TANF assistance. Last year she received an earned income tax credit of $900.
   - How much EITC income would you anticipate for the coming year?

7. Mrs. Brown sold her house to her son when she moved into assisted housing. The house was valued at $50,000. She sold it to her son for the market price but accepted a $15,000 cash payment that covered the outstanding balance on the mortgage and agreed that her son can pay the remaining balance over time.

   Mrs. Brown's son pays her $500/month on the outstanding loan balance. Of this amount, $492.50 goes to the principal and $7.50 goes to interest. Due to the informal nature of the loan arrangement, there is no amortization schedule and these amounts do not vary over time. You are processing Mrs. Brown's income for the coming 12-month recertification period.
   - What will be the actual annual asset income for this asset over the coming 12-month recertification period?

8. Sally won $15,000 in the lottery. She decided that this was a good time to save money for her ten year old daughter's higher education. She created a revocable trust that provides her daughter with $3,000 per year while attending college.
   a. How is this trust considered when completing rent and TTP calculations?

   b. Would your answer be any different (if at all) if Sally had established a nonrevocable trust?

9. Renee and her two children live in your development. The children's grandmother established a nonrevocable trust that provides money for private school for the two girls. The payments are made by a trustee (not Renee) directly to the school.
   - How would this arrangement be treated when calculating income for the family?

10. Mrs. Gray makes regular contributions to the Goodwill Industries.

a. Every year, Mrs. Gray makes a $750 cash donation to Goodwill. Mrs. Gray expects to make this same donation in the coming year as well..

- What amount would you count as an "asset disposed of for less than fair market value?" Explain your answer below.

Explanation:

b. In the past, Mrs. Gray has made $750 cash donation to Goodwill each year. However, for the last couple of years, rather than giving cash, Mrs. Gray has made regular contributions of clothing, canned goods and appliances to Goodwill over the course of the year. Mrs. Gray estimates that these contributions total about the same amount as her prior cash contributions. She expects to take this same approach to contributions in the coming year as well.

- What amount would you count as an "asset disposed of for less than fair market value?" Explain your answer below.

Explanation:

Module 5

Attachments

ATTACHMENT A – PRE-TRAINING SELF TEST ANSWERS

1. The creator of a trust always has access to trust funds, but the beneficiary of a trust only has access to revocable trust funds.
   a. True
   b. **False ****

Comment: The creator of a trust only has access to revocable trust funds. The creator of a trust does not have access to nonrevocable trust funds. The beneficiary of a trust may or may not have access to trust funds (revocable or nonrevocable) depending upon the terms of the trust. **Reference: 4350.3 REV-1, Par. 5-7G.1., Exhibit 5-2**

2. Business loans represent a debt for the business. In paying off this debt, an individual's regular payment will include an amount that is applied to the principal portion of the debt and an amount designated to pay the interest owed on the debt. For purposes of calculating net business income, the entire amount of the individual's regular loan payment is used as a business expense.
   a. True
   b. **False ****

Comment: Payments on the principal portion of a loan can never be used as a deduction from gross business income to determine net business income. Payments on the interest portion of some types of business loans may be used as a deduction from gross business income to determine net business income. **Reference: 4350.3 REV-1, Par. 5-6G.**

3. Equity in real property is known as the property's:
   a. Conversion value
   b. Principal value
   c. Cash value **
   d. Market value

Reference: 4350.3 REV-1, Par. 5-7C.

4. For purposes of calculating net business income to include in annual income, net business income equals gross business income minus what three (3) amounts?

   Net business income equals gross business income minus:

Business expenses
Interest on qualified business loans
Straight-line depreciation of certain business assets

Reference: 4350.3 REV-1, Par. 5-6G., Appendix 15-C.H.

5. To calculate a property's cash value, take the property's current market value and subtract what two (2) amounts?

   Cash value equals current market value minus:

Unpaid balance of loans secured by the property
Other costs that would be incurred in converting the property to cash (e.g., broker and legal fees, settlement costs, penalties, etc.)

   Reference: 4350.3 REV-1, Par. 5-7C., Exhibit 5-2

6. An asset that is placed in a nonrevocable trust by a family member would be considered an asset disposed of for less than fair market value.
   - **a. True ****
   - b. False

Comment: A family member who creates a nonrevocable trust can no longer access the trust funds. Therefore, these funds would be considered as asset disposed of for less than fair market value, similar to funds that have been given away to another party.

Reference: 4350.3 REV-1, Par. 5-7G.1, Par. 5-7G.6.

7. When a family member's main occupation is buying, selling or renting real estate, then any real estate owned by the family member and used in the business is not counted as an asset to the family.
   - **a. True ****
   - b. False

Comment: Where a family member's main occupation is buying, selling, or renting real estate, the family member has a real estate business. In this case the real property that the family member owns and uses in the business is not counted as a family asset but as a business asset. The rules for determining gross and net income from a business would apply when calculating the family member's annual income.

Reference: 4350.3 REV-1, Par. 5-6G., Exhibit 5-2

8. Earned income tax credit (EITC) payments received as a lump sum refund payment are not counted as annual income. However, EITC payments received periodically as regular advance payments must be counted in annual income.
   - a. True
   - b. **False ****

Comment: Any EITC payment, whether received as a lump-sum refund payment, after filing of taxes, or received periodically as advanced payments from an employer, are excluded from consideration as annual income.

Reference: 4350.3 REV-1, Par. 5-6P.3., Exhibit 5-1

9. Carlos, a handyman, has just completed painting an apartment for a customer. He is paid $800 for the job. For this particular job, Carlos spent $150 for supplies and paid his assistant $200. What is Carlos's gross income and net income for this job?

Answer:

Gross income for this job is **$800**

Net income for this job is **$450**

($800 gross income – $350 total expenses = $450)

Reference: 4350.3 REV-1, Par. 5-6G.

10. In order to encourage self-sufficiency and investment in real estate, if a family member's net income from their property is a negative amount, this amount is used to offset other family member income.
    a. True
    b. **False ****

Comment: If the net income from the property is negative, it cannot be used to offset other income. In this instance, net income from the property is recorded as zero.

Reference: 4350.3 REV-1, Par. 5-6G.

ATTACHMENT B – CASE STUDY 1 ANSWERS

Question 1: Business INCOME on the Statements

a. We begin with the 2004 Financial Statement and Schedule C. Based on a review of these two documents, what might you use for the following figures?

	Financial Statement	Schedule C
Gross Business Income:	**$47,310**	**$46,250**
Gross Business Expenses:	**$46,195**	**$44,159**
Net Business Income:	**$1,115**	**$2,091**

Comments: The Financial Statement makes it easy for us by specifically identifying Gross Income, Total Expenses and Net Income. Schedule C takes a little more effort but is still relatively simple, listing Gross income on Line 7, Total expenses on Line 28, and Net profit or (loss) on Line 31. However, just because the Financial Statement and Schedule C list income and expenses in this manner doesn't necessarily mean that this is the way we will need to categorize income and expenses.

b. Focusing only on business ***income***, what appears to be the major difference between the gross income figures from the Financial Statement and Schedule C?

Answer:

For gross income, Schedule C subtracts $1,060 for "Costs of Goods Sold" (from Part III of the form).

- $47,310 – $1,060 = $46,250

Comments: "Costs of Goods Sold" represents the value of the business inventory (supplies, products, goods, etc.) sold to customers during the year. Schedule C starts with the inventory at the beginning of the year, adds the value of goods added to the inventory during the year, and then identifies the inventory at the end of the year. The difference between the inventory at the beginning of the year and the inventory at the end of the year is the amount by which the inventory has increased or decreased. In this instance, the net result is that inventory *decreased* by $1,060 for the year. Schedule C's approach is to use this amount to reduce the gross profit of the business (on line 5) and, consequently, the gross income of the business (on line 7).

Question 2: Business EXPENSES on the Statements

a. **Readily Identifiable Expenses:** For identifying expenses, we'll start by looking for the obvious similarities between the 2004 Financial Statement and Schedule C. Both documents have several expenses and expense items that are the same, but referred to slightly differently on each form. The following chart lists expenses from the 2004 Financial Statement that should be readily identifiable as the same expenses on Schedule C. For each expense, identify where this expense is also found on Schedule C.

Amount	Financial Statement Description	Schedule C	
		Part II Line No.	Description
$12,000	Rent for Salon Space	**18**	**Office Expense**
$1,200	Utilities	**25**	**Utilities**
$19,000	Salaries	**26**	**Wages**
$1,000	Advertising	**8**	**Advertising**
$125	Business License	**23**	**Taxes and licenses**
$2,160	Taxes and Preparation		

b. **Miscellaneous Expenses:** The 2004 Financial Statement has a category of expenses labeled "miscellaneous" that is not readily identifiable on Schedule C. This category is relatively large – $1,100 – and not defined well enough to categorize it as a deductible business expense for calculating net business income. You ask for clarification from Jackie and she offers the following breakdown from her accountant, Ivan Pennywise:

Amount	Expense Item
$600	Accountant
$400	Bonus for Employee
$50	Charity
$25	Postage
$25	Food
$1,100	Total Miscellaneous

- With this additional information, you can now match up more 2004 Financial Statement expenses with their corresponding expenses on Schedule C.
- The following chart lists expenses from Schedule C that should now be readily identifiable as the same expenses on the Financial Statement. For each Schedule C expense category, identify the description and amount of the expense as recorded on the 2004 Financial Statement.

Amount	Schedule C		Financial Statement Description
	Part II Line No.	Description	
$5,854	14	Employee benefit programs	**FICA and Medicare ($1,454)** **Health Insurance ($4,000)** **Miscellaneous – Bonus ($400)**
$600	17	Legal and professional services	**Miscellaneous – Accountant ($600)**
$25	24b	Meals and entertainment	**Miscellaneous – Food ($25)**
$75	27	Other expenses (from line 48 on page 2)	**Miscellaneous – Charity ($50)** **Miscellaneous – Postage ($25)**

Comments: A relatively large, ill-defined category of expenses raises a concern of whether there is anything included in the category that is not business related. Often, for small business owners, the distinction between personal money and business money can get blurred. If, for example, Jackie bought groceries or rented a pony for her son's birthday and this cost was recorded under “miscellaneous,” this would be an expense to the business but should be counted as cash or assets withdrawn from the business and, as a result, income to the family.

Similarly, the “miscellaneous” category might include expenses that are directly business-related, but would also constitute income to the family. Since the business was showing a profit at the end of the year, the category might include any profit taken by the family from the business. Such profit-taking would be business-related (and one of the reasons Jackie went into business for herself), but it would also be counted as income to the family.

c. **Equipment and Supplies Expenses:** The 2004 Financial Statement includes general categories for "Equipment" ($400) and "Supplies" ($950) that are not readily identifiable on Schedule C.

- In discussing these categories with Jackie, you discover that the "equipment" category ($400) really includes things like scissors, brushes, and other smaller, non-capitalized equipment items used around the store. The "supplies" category ($950) includes hair products like shampoo, conditioner, hair gel, etc. Some of these products Jackie purchased for use as part of the business ($200) and some products Jackie purchased in order to sell to customers ($750).
- So, taking these two categories together, it appears that $600 ($400 + $200) worth of expenses are for equipment and supplies purchased for use by Jackie in the business and $750 worth of expenses are for products purchased to sell to customers.

- Examine Schedule C. How do you see these figures reflected on Schedule C?

Answer

Schedule C reflects the $600 worth of equipment and supplies purchased by Jackie for use in the business on line 22 (supplies not included in Part III).

Schedule C reflects the $750 worth of supplies and products purchased to sell to customers on line 36 of Part III. This section of Schedule C shows these $750 expenses as items purchased and added to inventory during the year.

Comments

Here we see a key difference in the manner in which the two financial documents reflect these $750 expenses.

The Financial Statement simply categorizes them as expenses for the year, like all other expenses.

On the other hand, Schedule C categorizes the expenses as additions to inventory, not as "expenses" per se.

When Jackie sells any goods from that inventory, she will generate sales receipts which will be reflected on Schedule C, line 1, "Gross receipts or sales." The "Inventory at end of year" in Part III, line 41, would then be reduced by the amount that Jackie spent on the goods. This would add to the "Costs of goods sold" on line 41 and line 4 which would, in turn, reduce the "Gross profit" on line 5. Hopefully, if everything works as planned, Jackie sells the goods for more than she spent on them, and this adds to her gross profits for the year.

These two methods could produce slightly different results, depending upon the volume of inventory purchased and sold in any given year.

Question 3: A Business Loan

As noted earlier, Jackie has a small business loan. In a prior reexamination, you established that the purpose of the loan was as Jackie has stated – a small business loan used to start up her business, back in 2003.

Up to this point, you've been able to account for all potential business expenses except the loan. Here's another area where the Financial Statement and Schedule C differ in their approach to recording loan information.

a. What expense do you see on the Financial Statement that is related to the business loan and how was this expense calculated?

Answer:

Under "Expenses", the Financial Statement includes a loan expense amount of $1,606. This amount was computed by multiplying the monthly loan payment ($133.81) by 12 months.

$133.81 x 12 = $1,605.72 = $1,606

b. What do you see on Schedule C that looks like it could be related to the business loan?

Answer: Part II, Line 16 of Schedule C includes $320 in "Other" interest payments for the year. It appears that this is only the interest that Jackie paid on her loan for 2004.

c. What does this tell you about the key difference between business loan expense reflected on Jackie's 2004 Financial Statement and business loan expense reflected on Schedule C?

Answer: Schedule C does not appear to include the principal payments on the business loan as an eligible business expense for 2004. However, the 2004 Financial Statement includes the full amount of loan payments for the year, both principal and interest, as an expense. Because the 2004 Financial Statement includes the principal portion of the loan payments as a business expense, this leads to a higher business loan expense figure on the Financial Statement than on Schedule C.

d. How will you handle principal and interest payments on Jackie's loan, in order to establish net business income for the recertification year beginning August 1st?

Answer: Based on the guidance in 4350.3 REV-1, Chapter 5, Par. 5-6G., interest on loans would be an eligible, deductible expense when determining net business income, as long as the loans were not for business expansion or capital improvements. In this instance, the purpose of the loan was not to expand a business, nor to purchase capital improvements for a business, but to actually start the business (purchase necessary supplies and equipment, pay initial rent and salaries, etc.). Therefore, the interest payments on the loan would be deductible as a business expense.

However, loan payments for the principal portion of a loan are never deductible as a business expense.

This means that we will need to differentiate between the interest portion of the loan payments and the principal portion of the loan payments for the recertification year beginning August 1st.

e. Jackie refers to her loan amortization schedule and indicates that loan payment no. 21 was her payment for December 2004. Loan payments no. 22 through no. 25 covered the first four months of 2005 (January – April) and she just made loan payment no. 26 for May 2005.
   - For the recertification period beginning August 1, 2005, provide the following information:

Total Principal to be paid in recertification year beginning August 1, 2005:	**$1,022.22**
Comment: Jackie will make 8 monthly loan payments in the recertification year beginning August 2005. This will be sufficient to retire the entire amount of the remaining principal – $1,022.22. Jackie will "pay off" the entire loan before the 12 month recertification period expires.	
Total Interest to be paid in recertification year beginning August 1, 2005:	**$48.52**
Comment: Based on the amortization schedule, total the interest portion of each loan payment for payments no. 29 (August) through no. 36 (March). This will equal the total interest to be paid: $10.65 + $9.37 + $8.07 + $6.76 + $5.44 + $4.10 + $2.75 + $1.38 = $48.52	

Question 4: Comparing 2004 Business Performance with 2005

a. As noted earlier, Jackie believes that 2005 will be "worse" than 2004. The Financial Statement Comparison form shows data from January through April of 2005, which is 1/3 (33%) of the 2005 calendar year. Looking at the Financial Statement Comparison form, why might Jackie think that her business is not doing well so far in 2005?

Answer: Jackie's gross business income through April 2005 is $14,832. However, her gross business expenses for the same period are $15,901. Therefore, through April 2005, based on the Financial Statement Comparison, Jackie's business has a net income loss of $1,069.

b. Look at the Financial Statement Comparison form and compare 2004 expenses with year-to-date 2005 expenses. Logically, you might expect year-to-date 2005 expenses to be about 1/3 (33%) of 2004 expenses. What do you see that might cast doubt on Jackie’s assessment that her business is not doing as well so far in 2005 as it did in 2004?

Answer:

Jackie’s expenses for Liability Insurance in 2004 were $1,200. This is exactly the amount that Jackie has paid for Liability Insurance so far in 2005. This suggests that the Liability Insurance may be a once-a-year premium payment that Jackie has already made for 2005 (unless premiums have increased and Jackie has only made a partial payment). So, it may be that Jackie will not incur any additional Liability Insurance payment premiums for the remainder of 2005. You will want to confirm this with Jackie.

Jackie’s expenses for Health Insurance in 2004 were $4,000. This is double the amount that Jackie has paid for Health Insurance so far in 2005. This suggests that the Health Insurance may be a twice-a-year payment that Jackie has already made for the first half of 2005 (again, unless these payments have increased and Jackie has only made a partial payment). So, it appears that Jackie could be about two months ahead on her Health Insurance payments for 2005. You will want to confirm this with Jackie.

It could be that Jackie's budget is “tight” right now because of the timing of her expenses. This might ease up as the year progresses, which could argue that there is no good reason to assume that Jackie's income will be smaller for 2005.

c. In comparing 2004 results with year-to-date 2005 results, what do you see that might support Jackie’s assessment that her business is not doing as well so far in 2005 as it did in 2004?

Answer: Jackie’s income so far in 2005 is a little less than 33% of her income in 2004.

Comment:

Jackie has paid a little less than 33% in various expense categories so far in 2005, as compared to 2004. These include FICA and Medicare, equipment, supplies, advertising, business license, taxes and miscellaneous.

However, some of these expenses categories are not significantly less than 33% of 2004 figures, and so may not have a significant impact by the end of 2005. In addition, some of the expense categories, such as equipment, supplies, advertising, miscellaneous, may reflect expenses that won’t necessarily be incurred at the same level in 2005 and 2004. Again, you will want to discuss this with Jackie.

Question 5: Tying up Loose Ends

You discuss Jackie's business further and determine the following:

- As suspected, liability insurance premiums are a once-per-year premium, paid at the beginning of the year. No further payments will be made until January 2006.
- As suspected, health insurance is paid twice per year – January and July. Next payment will be made in July.
- Jackie has yet to pay her business license for 2005, but must pay it before the end of the year.
- Jackie expects Salaries, FICA, Medicare and Taxes to be the same amount as 2004.
- Jackie has no plans to hire additional people or to expand. Nor does she expect to pay any bonus this year.
- Regarding her other expenses, Jackie has not purchased any new shop "equipment" for the year and doesn't anticipate any for 2005. Right now, she doesn't know about 2006.
- Jackie expects that her payments for rent, utilities, advertising, and miscellaneous expenses will be at about the same rate for the rest of 2005 as they have been so far in 2005.
- Regarding her income, Jackie has no idea if her business income might increase or if she will get more clients as the year goes. She hopes so but, for the time being, she thinks her business income will stay at about the same rate for the rest of the year as it has been so far this year.

Taking all of the information you have gathered, you are satisfied that the Financial Statement and the Financial Statement Comparison forms are consistent with Schedule C tax information and offer a reasonably accurate picture of Jackie's business income and expenses. There remain two areas where you may need to adjust the Financial Statement figures when projecting income and expenses for the coming year.

a. The financial statements reflect both principal and interest in the monthly loan payments. If you base your projection solely on financial statement data, you will calculate an annual loan expense of $1,606. What figure will you use for the loan expense for the recertification year beginning August 1, 2005? Explain your answer.

Answer: $48.52 ($49 rounded)
Explanation: Only interest payments on the loan are deductible as a business expense. In addition, Jackie will "pay off" her loan in the recertification year beginning August 1st. As calculated earlier, Jackie will pay $48.52 ($49 rounded) in interest on her loan for the recertification year beginning August 1st.

b. Based on your earlier review, you know that Schedule C makes a distinction between supplies purchased for business use (an expense) and supplies purchased to add to inventory and sell to customers. The financial statements do not make this distinction and include all supplies under one expense category.

You discuss this distinction with Jackie. Jackie notes that she has spent $150 on supplies so far in 2005 and expects to buy supplies at that same rate for the remainder of the year. This would be $450 in supplies for 2005 ($150 x 3).

Of that amount, Jackie estimates that about $250 of the supplies will be for business use and about $200 will be to sell to customers. Further, she expects to sell about the same amount of supplies that she buys for 2005.

- Based solely on this information, how will you categorize supplies for 2005? Explain your answer.

Answer: $250 can be clearly categorized as an "expense" to the business. The remaining $200 could either be categorized as an "expense" to the business or as "costs of goods sold" and a reduction to gross income.
Explanation: $250 represents the amount that Jackie expects to spend on supplies that she will use in the business. These are clearly business expenses. The remaining $200 would be handled differently on the financial statement and on Schedule C. On the financial statement, it would simply be categorized as an expense. However, on Schedule C, it represents an addition to inventory, not an expense. If Jackie "sells about the same amount that she buys" for 2005, then the "costs of goods sold" on Schedule C would be $200 and she will reduce her gross income by $200. So, in this situation, if Jackie's estimates are correct, it doesn't really matter if the $200 is categorized as an "expense" or as "costs of goods sold." The net effect will be the same – net income will be reduced by $200.

Question 6: Using the Information to Project Ahead

a. We should now have enough information to make a reasonable projection of Jackie's business income and expenses for the coming year. The following charts are based on the categories from the financial statements, with a few adjustments. Establish a 12 month projection for the business income and expenses..

Income	Jan – April 2005	Calculation	12-month Projection
Income from Services	$14,000	**14,000 x 3**	**$42,000**
Income from Product Sales	$800	**800 x 3**	**$2,400**
Interest on Checking	$32	**32 x 3**	**$96**
Costs of Goods Sold	NA	**450 - 250**	**($200)**
Gross Income:	$14,832	---------------------------	**$44,296**

Expenses	Jan – April 2005	Calculation	12-month Projection
Rent for Salon Space	$4,000	**4,000 x 3**	**$12,000**
Utilities	$400	**400 x 3**	**$1,200**
Salaries	$6,333	**Same as 2004**	**$19,000**
FICA and Medicare	$485	**Same as 2004**	**$1,454**
Liability Insurance	$1,200	**1 annual payment**	**$1,200**
Health Insurance	$2,000	**Same as 2004**	**$4,000**
Equipment	$0	**None**	**$0**
Supplies	$150	**(150 x 3) - 200**	**$250**
Advertising	$100	**100 x 3**	**$300**
Business License	$0	**1 annual payment**	**$125**
Taxes	$648	**Same as 2004**	**$2,160**
Loan Payment	$535	**Interest only = 48.52**	**$49**
Miscellaneous	$50	**50 x 3**	**$150**
Total Expenses:	$15,901	---------------------------	**$41,888**

Net Income	–$1,069	---------------------------	**$2,408**

b. What observations might you make which could explain the results?

Answer: Even though Jackie's income is projected to be slightly less than 2004, her countable expenses are even lower. Some of these lower expenses come as a result of reduced anticipated expenditures on equipment, supplies, advertising and miscellaneous.

Jackie sees her loan payment as an expense. However, you are only able to count the interest on the loan payments as an expense. Further, the loan will be fully paid off a few months into the recertification year beginning August 1, 2005. Therefore, you cannot count these payments for the entire year. This results in a fairly significant difference between the amount you may count as a loan payment expense ($49) and the amount that Jackie counted in 2004 ($1,606). This has the effect of increasing Jackie's net income.

Question 7: Annual Income

Assuming that the business is Jackie's only source of income, except for $86 in anticipated interest on her personal checking account, complete the following income portion of the rent calculation form..

3. Total Asset Income	Greater of **Line 2.** or **1e. Total**	$86

Annual Income

4a. Family Member Name	4b. FM #	Calculation	4c. Employment or Business	4d. Social Security, Pensions, etc.	4e. Public Assistance	4f. Other Income
Jackie	**1**	**$12,000/year salary**	**$12,000**			
Jackie	**1**	**Net business income**	**$2,408**			
4g. Total Income from each source			$**14,408**	$	$	$
5. Total Income All Sources			Add all amounts on **Line 4g.** above:			$**14,408**
6. Total Annual Income			Add **Line 5.** + Total Asset Income:			$**14,494**

Comment: Jackie draws a salary from the business. This salary must be counted as part of Jackie's income, as well as the net income from the business itself.

ATTACHMENT C – CASE STUDY 2 ANSWERS

Question 1

You have concluded that the house is an asset for Robert. What are the three basic pieces of information you will need in order to establish the cash value of the house?

Answer: In order to establish the cash value of the house, you need to know:

- The current market value of the house
- The unpaid balance of loans secured by the property
- The costs of converting the property to cash

Question 2

It is unlikely that the appraised value of the house ($90,000 at the time the brothers inherited the house) is still valid, given that the brothers have invested an additional $30,000 in house improvements. Review the forms provided by Robert. Based solely on this information, how would you calculate the market value of the house at this time?

Answer:

The tax assessment notice states that the assessed value of the house is $45,000. It goes on to state that the assessed value represents about 40% of the market value.

$45,000 assessed value ÷ .40 = **$112,500 market value**

Comment:

You should ask Robert if the house has been reappraised since the improvements. There may be more current and more accurate information on the market value of the home. The owner is not required to pay for an appraisal on the property. In this instance, the tax assessment notice may be your most reliable information. In addition, a market value of $112,500 seems fairly reasonable, given the original appraisal of $90,000 two years ago, and the improvements made by the brothers.

Question 3

Given that the house was used to secure the $30,000 loan, you will need to determine the unpaid balance of this $30,000 loan.

Following is an excerpt from an amortization schedule for the loan. The schedule shows the loan payments (principal and interest) for the period of time that overlaps with the recertification period (May 1, 2005 through April 30, 2006):

Payment No.	Principal	Interest	Cumulative Principal	Principal Balance
13 (Apr. 05)	$157.98	$246.82	$1,950.22	$28,049.78
14 (May 05)	$159.36	$245.44	$2,109.58	$27,890.42
15 (June 05)	$160.76	$244.04	$2,270.34	$27,729.66
16 (July 05)	$162.17	$242.63	$2,432.51	$27,567.49
17 (Aug. 05)	$163.58	$241.22	$2,596.09	$27,403.91
18 (Sept. 05)	$165.02	$239.78	$2,761.11	$27,238.89
19 (Oct. 05)	$166.46	$238.34	$2,927.57	$27,072.43
20 (Nov. 05)	$167.92	$236.88	$3,095.49	$26,904.51
21 (Dec. 05)	$169.39	$235.41	$3,264.88	$26,735.12
22 (Jan. 06)	$170.87	$233.93	$3,435.75	$26,564.25
23 (Feb. 06)	$172.36	$232.44	$3,608.11	$26,391.89
24 (Mar. 06)	$173.87	$230.93	$3,781.98	$26,218.02
25 (Apr. 06)	$175.39	$229.41	$3,957.37	$26,042.63

- Based on the table, what would you say is the unpaid balance of the $30,000 loan secured by the property?	$	**$28,050** (rounded)

Comment: Of the total $30,000 borrowed, the unpaid principal balance remaining as of the beginning of the recertification period was $28,049.78 (or, $28,050 rounded). This was the balance remaining at the end of April 2005, after the April payment was made.

Because the formula for determining cash value of the asset relies on the ***current*** market value of the house (i.e., the market value at the time of recertification effective date) it is reasonable that the unpaid balance of the loan should also be calculated based on the ***current*** unpaid balance (i.e., the unpaid balance at the time of the recertification effective date).

Question 4

You contact a couple of local real estate agents and both verbally confirm that, at this point in time, should the Barker brothers decide to sell the home, the estimated costs, commission and fees associated with the sale would be about $5,000.

a. Relying on the information you have, what would be the Cash Value of the house co-owned by Robert Barker?

Answer: $79,450 ($112,500 – $28,050– $5,000 = $79,450)

b. Based on your answer to 4.a., what will you count as an asset for Robert Barker?

Answer: $19,863 (rounded)— [$79,450 ÷ 4 = $19,862.50 ($19,863 rounded)]
Comment: You have established Robert as co-owner of the property. It’s worth asking Robert the question of whether there is some arrangement in the deed whereby the brothers do not share equally in the value of the home. However, absent any information to the contrary, you assume that the brothers do share equally in the value of the home. Therefore, Robert’s share of the cash value of the asset is the ¼ of the total cash value of the asset.

Question 5: Gross Asset Income

The brothers currently have a tenant in the house, with an executed lease for the period of January 2005 through December 2005. Robert provides you with a copy of that lease (not included with this case study) which shows that the lease has been executed with John Q. Tenant for the 12-month period beginning January 1, 2005, at a monthly rental rate of $1,200.

However, Robert reports that the brothers have had trouble keeping tenants in the house. They seem to keep getting tenants who stay for a few months, then leave. Last year, they only received $10,800 in rent (as evidenced by the income and expense report). The year before (2003), the brothers received only $9,600 in rent.

- How would you anticipate gross income for the property in the coming year?

Answer: $14,400
Comments: You should discuss with Robert the reasons why the brothers were unable to keep the house rented for the entire year. The brothers’ two-year history with renting the house may or may not be indicative of a pattern that will repeat in the future. It could be that, with the original condition of the home and the improvements made by the brothers in the past year, it was more difficult to attract a reliable tenant. However, while the brothers may be skeptical that any tenant will remain in the unit the entire year, the fact remains that they do currently have a tenant with a 12-month lease. Further, even if the current tenant were to vacate, it is not unreasonable to expect the brothers to re-rent the house without a loss in rental income. In any event, given that the brothers currently have the house under lease and absent any compelling reason to believe otherwise, projecting a full 12 months of rental income is a reasonable approach. Late payments in the past year were based on unanticipated events and would not generally be counted in gross anticipated income for the coming year

Question 6: Asset Expenses

You examine the Income and Expense Report for the house, as well as the receipt provided by Robert to support one expense item (new carpeting).

a. You notice that the receipt for the carpeting shows an expense of $1,193.50. You also note that the income and expense report shows an expense of $1,400, with a note that the improvements include labor charges of $206.50. Robert explains that he purchased the carpeting, installed it himself during his vacation and decided to include some charge for his labor. He figured that an additional $200 or so was about right for the job, and so claimed a reimbursement for an even $1,400.

- Is it OK for Robert to charge for his labor?	**Yes**
- Should we count the $206.50 as income for Robert?	**Yes**

Explanation:

Nothing would prevent Robert from reimbursing himself for labor incurred in managing, maintaining or improving the property. This can be a legitimate expense for maintaining the asset. However, the amount of the reimbursement for labor must also be counted as income to Robert. Similar to business income, Robert could not simply claim that his withdrawal of cash from the asset was a reimbursement of his "labor" invested in the house and, therefore, not to be counted as income.

Comments:

In this instance, the additional amount of annual income ($206.50/year) was below the threshold ($200/month) by which the family should have reported an increase for purposes of an interim recertification.

You should discuss with Robert whether the brothers are planning similar improvement expenses in the coming year. If you conclude that a similar expense, with similar labor charges, are to be incurred in the coming year, then the anticipated expense could be counted and the appropriate amount of labor reimbursement would be counted as income to Robert.

b. You notice that the income and expense report shows an expense of $635 for a "management fee." Robert explains that his brother Russell takes the lead responsibility for "managing" the property (e.g., maintenance, leasing, etc.). Russell charges a management fee of about 4.5% of rental income. Because Russell lives out of town, he also incurs travel and long distance telephone expenses related to communication with the brothers about the property, as well as travel to the property for inspections and repairs.

- Is it OK for Russell to charge a management fee, as well as charge for travel and telephone expenses? (Explain your answer below)	**Yes**

Explanation

As with Robert, nothing would prevent Russell from reimbursing himself for the time and expense involved in managing the property. Travel and telephone expenses can be legitimate expenses for maintaining the asset. You should discuss with Robert whether these expenses are expected to change over the coming year, and whether he can secure any documentation of these expenses from Russell.

c. You notice that the income and expense report shows an expense of $900 for "damage repair." Robert explains that their prior tenants, the Johnson family, left considerable damage to the house. Robert notes that Russell collects a damage deposit of $500, but it was not sufficient to cover the damages left by this particular family. Robert states that "you never know about people", and that there is just no way to tell if their current tenant family or the next tenant family will also leave with similar damages.

- Will you allow the damage repair expenses again this year? (Explain your answer below.)	**Maybe**

Explanation:

You would need to discuss with Robert the exact nature of these repairs. Are they directly attributable to this specific family? Would some of the repairs have been made anyway as routine maintenance and the result of normal wear-and-tear, regardless of the Johnson family? Generally, repair of excessive damages over and above the amount covered by a damage deposit should be the exception, not the rule. Even when such damages occur, the landlord would have some recourse to seek repayment from the family through legal action. As a rule, such expenses are unanticipated expenses and would *not* be included in a projection of anticipated expenses for the coming year.

d. Robert provides you with the following additional pieces of information about the expenses listed on the income and expense report.

- Water/sewer/trash expenses are expected to go up for the coming year, as evidenced by the Notice of Change in Water/Sewer/Trash Assessment provided by Robert.
- Gas and electricity expenses will be about the same. No changes are anticipated in gas or electric rates. Robert provides you with copies of recent utility receipts that support these expenses.
- Robert states that the brothers are not anticipating any additional improvements for the coming year.
- As the "manager" of the house, Russell takes care of the regular maintenance and supplies on the house. Robert states that Russell did not keep copies of the any receipts for maintenance and supplies, but believes the $300 total to be "about right." Robert also expects Russell to continue to charge the same management fee and incur the same phone expenses in the coming year. The brothers have planned a face-to-face meeting next quarter about selling the house. Robert suggests that using the same travel expenses as last year will cover that meeting. Robert signs a certification attesting to the accuracy of the amounts.
- Robert explains that the brothers were late on one of their tax payments last year. As a result, the taxes they paid ($1,680) were a little more than what they would have paid (about $1,500) if they had paid on time. Robert has provided you with a copy of the current Notice of Tax Assessment.

The following chart lists all of the expense items from the Income and Expense Report for 2004. Based on all of the information you have, complete the chart.

- Indicate the amount of the expense you will count as anticipated expenses for the coming year, and the amount that you will not count, for purposes of computing net income on the house.
- Where there are additional expenses you will count that are not listed, add them to the chart.
- Give a brief explanation of your decision for each expense item.

	Annual Amount	
Expense Item	**Counted**	**Not Counted**
Water/Sewer/Trash	**$200**	
Gas	**$900**	
Electricity	**$400**	
Regular Maintenance and Supplies	**$300**	
Damage Repair		**$900**
Improvements		**$1,400**
Taxes	**$1,575**	
Management Fee	**$648**	
Travel	**$450**	
Telephone	**$240**	
Loan Payments	**$2,850**	
Other:		
Other:		
Total:	**$7,563**	**$2,300**

Explanations:

Water/Sewer/Trash: Notice of Change provided by Robert shows that water/sewer/trash collection charges for single family units will increase to $50/quarter beginning May 1st. $50/quarter x 4 quarters = $200.

Gas: Based on documentation provided by Robert, and no anticipated changes, anticipated expenses computed the same as 2004.

Electricity: Based on documentation provided by Robert, and no anticipated changes, anticipated expenses computed the same as 2004.

Regular Maintenance and Supplies; Management Fee; Travel; Telephone: It is reasonable to expect that the brothers (Russell, in this case) would incur some level of effort and expense associated with managing and maintaining the house as a rental property. It's reasonable to expect that Russell should be reimbursed for direct expenses incurred in managing/maintaining the property (supplies, materials, telephone bills, travel expenses). Further, nothing would prevent Russell from reimbursing himself for his effort, time and expense involved in managing the property.

However, you would want to see some documentation of these expenses. It is likely that Russell will be maintaining some record of his direct expenses (e.g., receipts) as well as his management fees. Given Russell's role, it is likely that Russell is claiming the rental income and expenses on his taxes (Form 1040, Schedule E). Russell may or may not be willing to share this tax information with Robert. Russell may be willing to share the back-up documentation used to justify the expenses, or be willing to sign a certification attesting to the accuracy of the amounts.

In any event, a certification from Robert alone is not the highest level of documentation for these expenses. You should pursue a higher level of documentation directly from Russell, but the certification from Robert may be the best documentation that you're able to secure given that your relationship is with Robert, not with Russell. In this instance, we are counting the expenses based on Robert's certification. You may make a different determination.

Damage Repair: No amounts have been included for damage repair for the coming year. As a rule, such expenses are unanticipated expenses, over and above normal wear-and-tear and over and above the damage deposit, and would not be included in a projection of anticipated expenses for the coming year.

Improvements: Based on information provided by Robert, no additional improvements are planned for the coming year. So no improvement expenses are counted.

Taxes: Notice of Tax Assessment provided by Robert shows that taxes are due twice a year - $788 due on June 1st; $787 due on December 1st. $788 + $787 = $1,575. Despite the fact that the brothers were late with a tax payment last year, no additional expense is included for the coming year in anticipation of a late payment.

Loan Payment: While the brothers' loan payment is $404.80 per month, the principal portion of that payment cannot be counted as an expense. Using the amortization table provided earlier, total all of the interest portion of the payments for the months of May 2005 (payment 14) through April 2006 (payment 25). This total is $2850 (rounded), and may be included as an expense.

Additional Expenses: None are anticipated for the coming year, based on the information provided.

Question 7: Net Asset Income

a. Based on your answers to Questions 5 and 6, what do you anticipate will be the net income generated by the house in the coming year?

Answer: $6,837 ($14,400 – $7,563 = $6,837)

b. Based on your answer to 7.a., what will you count as net asset income for Robert Barker?

Answer: $1,709 (rounded) [$6,837 ÷ 4 = $1,709.25 ($1,709 rounded)]

Question 8: Calculating Income and Rent

Using the charts following, calculate income and rent for the Barkers at this annual recertification.

Asset Income

1a. Family Member Name	FM #	1b. Asset Type	1c. C/I	Calculation for Asset Cash Value (mv - expenses)	1d. Cash Value of Asset	Calculation for Asset Income (mv x int/div)	1e. Actual Annual Asset Income
Robert, Vana	1,2	Checking		200 – 0	$200		$0
Robert, Vana	1,2	Savings		600 – 0	$600	600 x 0.0167	$10
Sally J.	3	Savings		100– 0	$100		$0
Oprah	4	Savings		100 – 0	$100		$0
Robert	1	Rental		(112,500 – 28,050 – 5,000) ÷ 4	$19,863		$1,709
				TOTAL	**$20,863**		**$1,719**
If **1d. Total** is *greater than $5,000,* complete **Line 2.** and **Line 3.** If **1d. Total** is *less than or equal to $5,000,* enter $0 in **Line 2.**; complete **Line 3.**							
2. Imputed income from assets				HUD approved passbook rate (.02) x **1d.Total**			**$417**
3. Total Asset Income				Greater of **Line 2.** or **1e. Total**			**$1,719**

Comment: Note that Robert's share of the house is recorded as the cash value of the asset to Robert. Robert's share of the net income from the asset is recorded as actual asset income for Robert.

Annual Income

4a. Family Member Name	4b. FM #	Calculation	4c. Employment or Business	4d. Social Security, Pensions, etc.	4e. Public Assistance	4f. Other Income
Robert	1	7.50 x 32 x 48	$11,520			
4g. Total Income from each source			**$11,520**	$	$	$
5. Total Income All Sources		Add all amounts on **Line 4g.** above:				**$11,520**
6. Total Annual Income		Add **Line 5.** + Total Asset Income:				**$13,239**

Comment: Robert records his total income as about "$11,000 or so" on the recertification form. However, you must base his income on verified data (hours, rate of pay, etc.) from his employer. In this case, the data shows:

- $7.50/hour x 32 hours/week x 48 weeks = $11,520

Adjusted Income

6. **Total Annual Income**: Carryover from **Line 6.** on **Annual Income** table			$13,239
7. **Enter 3% of Total Annual Income** (Line 6. x .03)		$397	
Dependent Allowance			
8. **Allowance for Dependents** (# of dependents __2__ x $480)			$960
Child Care Allowance			
9. **Child Care Allowance** (Line 8a. plus Line 8b.)			$0
9a. Expense enabling family member to work (may not exceed $ earned by family member enabled to work)		$	
9b. Expense enabling family member to attend school and/or look for work		$	
Elderly/Disabled Household Allowance			
10. **Elderly/Disabled Household Allowance** ($400 or $0)			$400
Disability Assistance Expenses			
11. **Enter total unreimbursed disability assistance expenses:**		$0	
12. **Maximum allowable disability assistance expense** (Line 11. minus Line 7.) • If positive or zero, enter in **Box 12a.** • If negative, enter as positive number in **Box 12b.**	12a.	$	
	12b.	$397	
13. **Enter $ earned by family member enabled to work as a result of disability expenses**		$0	
14. **Enter lower of Line 12a. or Line 13.** If Line **12a.** is blank or zero, enter zero		$0	
Medical Expenses			
15. **Enter the total annual unreimbursed medical expenses for all family members of a disabled or elderly family**		$3,960	
Medical/Disability Assistance Expenses Allowance			
16. **Enter the total of Line 14. and Line 15.**		$3,960	
17. **Enter Line 12b.** If Line **12b.** is blank or zero, enter zero.		$397	
18. **Medical/Disability Assistance Expense: Line 16.** minus **Line 17.** (but not less than zero)			$3,563
19. **Total Allowances: Total of Lines 8., 9., 10. and 18.**			$4,923
Total Adjusted Income			
20. **Adjusted Annual Income: Line 6.** minus **Line 19**			$8,316

Comment: Family qualifies as a "Disabled" family because spouse, Vana, is a person with disabilities. As such, the family is eligible for elderly/disabled family deduction and a medical expenses deduction.

On the recertification form, the family reports medical expenses of $100/month for a hospital bill (with an outstanding balance of $5,000), $150/ month for prescriptions, and $80/month for regular doctor's visits by Vana (unreimbursed by health insurance).

($100 x 12) + ($150 x 12) + ($80 x 12) = **$3,960 unreimbursed medical expenses**

Tenant Rent Calculation

1.	**Monthly Income** (Line 6. from Annual Income table ÷ 12)		**$1,103**
2.	**Monthly Adjusted Income** (Line 20. from Adjusted Income table ÷ 12)		**$693**
3.	**30% of Monthly Adjusted Income** (Line 2. x .30)		**$208**
4.	**10% of Monthly Income** (Line 1. x .10)		**$110**
5.	**Welfare Rent** (If applicable)		**NA**
6.	**Minimum Rent** ($25 for Section 8 / $0 for PAC/PRAC)		**$25**
7.	**Total Tenant Payment** (greater of Line 3., 4., 5., or 6.) ***Note***: May never exceed unit gross rent in Sec. 8 or PAC programs.		**$208**
8.	**Utility Allowance** (UA)		**$95**
9.	**Tenant Rent**: TTP – UA	**a. Tenant Rent:** If positive number, enter	**$113**
	(Line 7. minus Line 8.)	**b. Utility Reimbursement:** If negative number, enter as positive	$

Assistance Payment Calculation

1.	**Contract Rent:**	**$1,100**
2.	**Utility Allowance** (same as Line 8. on Tenant Rent Calc. table)	**$95**
3.	**Gross Rent** (Line 1. plus Line 2.)	**$1,195**
4.	**TTP** (same as Line 7. on Tenant Rent Calc. table)	**$208**
5.	**Assistance Payment:** (Line 3. minus Line 4.)	**$987**
	5.a. Assistance Payment to Owner for Rent (Lesser of Line 5. or Line 1.)	**$987**
	5.b. Assistance Payment to Owner for Utility Reimbursement (Line 5. minus Line 5.a.) ***Note***: Should equal **Line 9.b.** on **Tenant Rent Calc**. table	**$0**

ATTACHMENT D – CASE STUDY 3 ANSWERS

Case Study 3A: A Generous Grandmother

Question 1

What are Wilma's assets and what are the values of those assets?

Answer:

Wilma has a checking account with a balance of **$8,500.**

Wilma has **$56,000** worth of assets disposed of for less than fair market value (FMV) that must continue to be counted as an asset for two years from the date they were disposed.

Appraised Value of House:	$80,000
Estimated Sales Charge:	– $4,000
Cash Value of House:	= $76,000
Amount received for sale of house	– $50,000
Amount disposed of for less than FMV	= $26,000

Wilma established a nonrevocable trust for Eileen of $30,000. Because the trust is nonrevocable, Wilma no longer has any control over the principal balance. Thus, $30,000 is considered as an asset disposed for less than fair market value.

$26,000 + $30,000 = **$56,000**

Question 2

Using the information you have, and assuming adequate verification of Betty's employment income and checking account, as well as Wilma's savings account, social security income and pension income, compute income and rent for the family on the following pages.

Asset Income

1a. Family Member Name	FM #	1b. Asset Type	1c. C/I	Calculation for Asset Cash Value (mv - expenses)	1d. Cash Value of Asset	Calculation for Asset Income (mv x int/div)	1e. Actual Annual Asset Income
Betty	1	Checking		500 – 0	$500		$0
Wilma	3	Savings		8,500 – 0	$8,500	8,500 x .0175	$149
Wilma	3	House		80,000 – 4,000 – 50,000	$26,000		$0
Wilma	3	Trust		30,000 – 0	$30,000	200 x 12	$2,400
				TOTAL	**$65,000**		**$2,549**
If **1d. Total** is *greater than $5,000,* complete **Line 2.** and **Line 3.** If **1d. Total** is *less than or equal to $5,000,* enter $0 in **Line 2.**; complete **Line 3.**							
2. Imputed income from assets				HUD approved passbook rate (.02) x **1d.Total**			**$1,300**
3. Total Asset Income				Greater of **Line 2.** or **1e. Total**			**$2,549**

Annual Income

4a. Family Member Name	4b. FM #	Calculation	4c. Employment or Business	4d. Social Security, Pensions, etc.	4e. Public Assistance	4f. Other Income
Betty	1	8.50 x 40 x 52	$17,680			
Wilma	3	900 x 12		$10,800		
Wilma	3	350 x 12		$4,200		
4g.Total Income from each source			**$17,680**	**$15,000**	**$**	**$**
5. Total Income All Sources					Add all amounts on **Line 4g.** above:	**$32,680**
6. Total Annual Income					Add **Line 5.** + Total Asset Income:	**$35,229**

Comment: Betty records her total income as about "$15,000 or so" on the recertification form. However, you must base his income on verified data (hours, rate of pay, etc.) from her employer. In this case, the data shows:

$8.50/hour x 40 hours/week x 52 weeks = **$17,680**

Adjusted Income

6. **Total Annual Income**: Carryover from **Line 6.** on **Annual Income** table			**$35,229**
7. **Enter 3% of Total Annual Income** (Line 6. x .03)		**$1,057**	
Dependent Allowance			
8. **Allowance for Dependents** (# of dependents __1__ x $480)			**$480**
Child Care Allowance			
9. **Child Care Allowance** (Line 8a. plus Line 8b.)			**$0**
9a. Expense enabling family member to work (may not exceed $ earned by family member enabled to work)	$		
9b. Expense enabling family member to attend school and/or look for work	$		
Elderly/Disabled Household Allowance			
10. **Elderly/Disabled Household Allowance** ($400 or $0)			**$0**
Disability Assistance Expenses			
11. **Enter total unreimbursed disability assistance expenses:**	$		
12. **Maximum allowable disability assistance expense** (Line 11. minus Line 7.) • If positive or zero, enter in **Box 12a.** • If negative, enter as positive number in **Box 12b.**	12a. 12b.	$ $	
13. **Enter $ earned by family member enabled to work as a result of disability expenses**	$		
14. **Enter lower of Line 12a. or Line 13.** If Line **12a.** is blank or zero, enter zero	$		
Medical Expenses			
15. **Enter the total annual unreimbursed medical expenses for all family members of a disabled or elderly family**	$		
Medical/Disability Assistance Expenses Allowance			
16. **Enter the total of Line 14. and Line 15.**	$		
17. **Enter Line 12b.** If Line **12b.** is blank or zero, enter zero.	**$0**		
18. **Medical/Disability Assistance Expense: Line 16.** minus **Line 17.** (but not less than zero)			**$0**
19. **Total Allowances: Total of Lines 8., 9., 10. and 18.**			**$480**
Total Adjusted Income			
20. **Adjusted Annual Income: Line 6.** minus **Line 19**			**$34,749**

Comment: Note that, on the recertification form under the Medical Expenses category, the family indicates that the head or spouse is a person 62 years of age or older. The family then records $100/month in medical expenses. However, Wilma (age 75) is not the head or spouse but an "other adult." Therefore, the family does not qualify for the elderly family deduction or a deduction for medical expenses.

Tenant Rent Calculation

1.	**Monthly Income** (Line 6. from Annual Income table ÷ 12)		**$2,936**
2.	**Monthly Adjusted Income** (Line 20. from Adjusted Income table ÷ 12)		**$2,896**
3.	**30% of Monthly Adjusted Income** (Line 2. x .30)		**$869**
4.	**10% of Monthly Income** (Line 1. x .10)		**$294**
5.	**Welfare Rent** (If applicable)		**NA**
6.	**Minimum Rent** ($25 for Section 8 / $0 for PAC/PRAC)		**$25**
7.	**Total Tenant Payment** (greater of Line 3., 4., 5., or 6.) ***Note***: May never exceed unit gross rent in Sec. 8 or PAC programs.		**$869**
8.	**Utility Allowance** (UA)		**$82**
9.	**Tenant Rent**: TTP – UA	**a. Tenant Rent:** If positive number, enter	**$787**
	(Line 7. minus Line 8.)	**b. Utility Reimbursement:** If negative number, enter as positive	**$0**

Assistance Payment Calculation

1.	**Contract Rent:**	**$1,000**
2.	**Utility Allowance** (same as Line 8. on Tenant Rent Calc. table)	**$82**
3.	**Gross Rent** (Line 1. plus Line 2.)	**$1,082**
4.	**TTP** (same as Line 7. on Tenant Rent Calc. table)	**$869**
5.	**Assistance Payment:** (Line 3. minus Line 4.)	**$213**
	5.a. **Assistance Payment to Owner for Rent** (Lesser of Line 5. or Line 1.)	**$213**
	5.b. **Assistance Payment to Owner for Utility Reimbursement** (Line 5. minus Line 5.a.) ***Note***: Should equal **Line 9.b.** on **Tenant Rent Calc**. table	**$0**

Question 3

Eileen will turn age 18 on September 12, 2012.

a. Under what circumstances would Eileen become and remain a beneficiary of the trust? What additional information might you need about the trust in order to make this determination?

Answer:
Eileen would become a beneficiary of the trust if she can demonstrate that she is enrolled as a full-time student in college. It is unclear from this scenario whether any additional criteria would need to be fulfilled (e.g., 4-year program, 2-year program, maintain enrollment for the entire year, maintain a certain academic status, etc.).

To remain a beneficiary, Eileen would need to continue to be enrolled as a full-time student in college for five years. Again, it is unclear whether there are additional criteria here (e.g., enrollment for five consecutive years, etc.)

If Eileen graduates, Eileen would receive a lump-sum for any balance remaining in the trust. Again, it is unclear whether there are additional criteria (e.g., if Eileen graduates in 3 or 4 years, would she need to wait until the fifth year before receiving a lump-sum?).

b. Assuming that Eileen becomes a beneficiary of the trust when she turns age 18 and assuming that she continues to live in assisted housing; will you exclude the trust income for Eileen? Explain your answer.
   - Yes
   - **No****

Explanation:
While Eileen will be 18 and a full-time student, the income she receives is not *earned* income. So the amount over $480 is not excluded.
As a beneficiary of the trust, Eileen will be receiving regular periodic payments from the trust (4 times a year for up to 5 years). As such, these payments are countable as income.
Comment: One uncertainty in this scenario is the nature of the trust itself. Is the trust intended to be “student financial assistance”, or is the trust intended to be an incentive for Eileen to get a college education? Student financial assistance paid directly to the student is excluded from consideration as annual income. From the information presented here, it does not appear that the money from the trust is “student financial assistance” per se. It appears to be simply an incentive to encourage Eileen to go to school, remain in school and graduate. As long as Eileen maintains her status as a student, there appear to be no restrictions that would permit the money to be used only for financial assistance related to school expenses. Nevertheless, the trust should be examined closely to determine if the money would, in fact, qualify as “student financial assistance” and so be excluded. The owner should discuss this issue with the trustee.

Case Study 3B: A Cautious Arrangement

Question 1

a. The law defines a small business concern as "one that is independently owned and operated and which is not dominant in its field of operation." In essence, Margarita is operating a small business with herself as the sole employee. What would you like to see from Margarita to establish her self-employment income?

Answer:

Margarita needs to provide you with documentation establishing her annual income from her cleaning business, as well as her business expenses.

Possible documentation Margarita could provide includes:

- Tax returns, including Schedule C for small businesses
- Audited or unaudited financial statements of the business, if any
- Records of payments received for her services (e.g., checks from clients, cash deposited, etc.)
- Any financial records Margarita maintains, records of days and hours worked, payment received, rates of payment, among other information
- Records and receipts for any expenses she incurs (supplies, materials, products, etc.)

Margarita could also provide a notarized statement as to net income realized from the business during the previous years.

b. Margarita is able to provide you with cancelled checks showing some work done over the past couple of months. She states that much of her work during this time was paid with cash, and she cannot produce any cancelled checks for these jobs. She is able to provide you with an appointment calendar, dating back to the beginning of the year, where she records all of her scheduled jobs. She is also able to provide you with bank statements for the last 3 months, showing a number of deposits, though Margarita admits that she mixes work cash deposits with personal cash deposits and withdrawals all of the time. She claims to have not yet filed her taxes for last year, and cannot find any tax returns for previous years.

By going through the calendar with her, you are able to determine that Maria worked an average of 140 hours each month for the past six months, dating back to January 1st. The checks that she produces are consistent with a rate of $8.00/hour. The bank statement deposits do not provide a clear record of cash deposits consistent with hours worked.

Margarita states that she has no expenses for supplies and equipment. These are all provided by her clients. Margarita says she is willing to sign a certification that the information she has provided is accurate.

- How would you approach Margarita's work income and what figure would you use for net income?

Answer: Under these circumstances, assuming Margarita has no recent tax return and no formal financial statement, the information provided by Margarita may be the best information you can obtain. At a minimum, you should compute the results, record them, have Margarita sign the document and have the document notarized. Based on the information provided: • 140 hours/month x 12 months x $8.00/hour -= **$13,440 gross income** Because Margarita claims no business expenses, **$13,440** would also be the **net income** from the business.
Comment: Because Margarita's business is very small and her payment arrangements are fairly informal, you should discuss with Margarita the importance of maintaining clear and complete records. This would be a benefit to her, for tax purposes, but would also be essential for you to compute income and rent.

Question 2

How much of the $100,000 principal of the trust will you count as an asset for the following individuals? Explain your answers:

Margarita:	$	**0**
Leonard:	$	**0**
Alicia:	$	**0**

Explanation: The principal in the trust would not be counted as an asset for Margarita or for either of the children because they do not have access to the principal amount.

Question 3

a. How much of the $500/month that comes from the trust will you count as income for the following individuals? Explain your answers:

Margarita:	$	**500/month**
Leonard:	$	**0/month**
Alicia:	$	**0/month**

Explanation: Even though the funds are designated for the care of the children, they are received by Margarita and are available as income to the family.

b. Assume that both Leonard is now age 22 and Alicia is age 21. Alicia is a full-time student and Leonard works part-time. Both still lives at home with Margarita. What will you count as monthly income from the trusts for the following individuals? Explain your answers.

Margarita:	$	**0/month**
Leonard:	$	**250/month**
Alicia:	$	**250/month**

Explanation: Periodic payments from the trust will continue to be counted as long as Leonard and Alicia are family members remaining in the household. Only the earned income above $480 is excluded for full-time students over age 18, so no income would be excluded for Alicia.

Question 4

Assume that you are conducting an annual recertification for Fred and Ethel Katz..

a. How much of the $100,000 principal of the trust will you count as an asset for them? Explain your answer below.	$	**100,000**

Explanation: The trust is a ***revocable*** trust. As such, the entire amount remains available to Fred and Ethel and they are able to access it and withdraw it at any time.

b. Given that Fred and Ethel liquidated other assets to set up the trust, how much of the trust will you consider an asset disposed of for less than fair market value? Explain your answer below.	$	**0**

Explanation: The trust is a ***revocable*** trust. Only assets placed in ***nonrevocable*** trusts are considered as “assets disposed of for less than fair market value.” As discussed in 4.a. above, the entire amount of the revocable trust remains available to Fred and Ethel and they are able to access it and withdraw it at any time. Therefore, the fact that they liquidated other assets to create the trust is irrelevant.

c. How much of the $500/month that comes from the trust will you count as income for Fred and Ethel? Explain your answer below.	$	**0/month**

Explanation: The periodic payments from the trust go to Margarita Katz and her family. So, none of this payment is counted as income for Fred and Ethel. However, because the trust is still counted as an asset for Fred and Ethel, any interest earned on the trust (even if reinvested) would be counted as asset income for Fred and Ethel.

Question 5

Using the information you have, and assuming adequate verification of Margarita’s checking account, pension income and trust, compute income and rent for the family on the following pages.

Asset Income

1a. Family Member Name	FM #	1b. Asset Type	1c. C/I	Calculation for Asset Cash Value (mv - expenses)	1d. Cash Value of Asset	Calculation for Asset Income (mv x int/div)	1e. Actual Annual Asset Income
Margarita	1	Checking		5,500 – 0	$5,500		$0
				TOTAL	**$5,500**		**$0**
If **1d. Total** is *greater than $5,000,* complete **Line 2.** and **Line 3.** If **1d. Total** is *less than or equal to $5,000,* enter $0 in **Line 2.**; complete **Line 3.**							
2. Imputed income from assets				HUD approved passbook rate (.02) x **1d.Total**			**$110**
3. Total Asset Income				Greater of **Line 2.** or **1e. Total**			**$110**

Annual Income

4a. Family Member Name	4b. FM #	Calculation	4c. Employment or Business	4d. Social Security, Pensions, etc.	4e. Public Assistance	4f. Other Income
Margarita	1	8.00 x 140 x 12	$13,440			
Margarita	1	300 x 12		$3,600		
Margarita	1	500 x 12				$6,000
4g.Total Income from each source			**$13,440**	**$3,600**	$	**$6,000**
5. Total Income All Sources						**$23,040**
6. Total Annual Income					Add **Line 5.** + Total Asset Income:	**$23,150**

Adjusted Income

6. **Total Annual Income**: Carryover from **Line 6.** on **Annual Income** table		**$23,150**
7. **Enter 3% of Total Annual Income** (Line 6. x .03)	**$695**	
Dependent Allowance		
8. **Allowance for Dependents** (# of dependents __2__ x $480)		**$960**
Child Care Allowance		
9. **Child Care Allowance** (Line 8a. plus Line 8b.)		**$0**
9a. Expense enabling family member to work (may not exceed $ earned by family member enabled to work)	$	
9b. Expense enabling family member to attend school and/or look for work	$	
Elderly/Disabled Household Allowance		
10. Elderly/Disabled Household Allowance ($400 or $0)		**$0**
Disability Assistance Expenses		
11. Enter total unreimbursed disability assistance expenses:	$	
12. Maximum allowable disability assistance expense (Line 11. minus Line 7.) • If positive or zero, enter in **Box 12a.** • If negative, enter as positive number in **Box 12b.**	12a. $ 12b. $	
13. Enter $ earned by family member enabled to work as a result of disability expenses	$	
14. Enter lower of Line 12a. or Line 13. If Line **12a.** is blank or zero, enter zero	$	
Medical Expenses		
15. Enter the total annual unreimbursed medical expenses for all family members of a disabled or elderly family	$	
Medical/Disability Assistance Expenses Allowance		
16. Enter the total of Line 14. and Line 15.	$	
17. Enter Line 12b. If Line **12b.** is blank or zero, enter zero.	**$0**	
18. Medical/Disability Assistance Expense: Line 16. minus **Line 17.** (but not less than zero)		**$0**
19. Total Allowances: Total of Lines 8., 9., 10. and 18.		**$960**
Total Adjusted Income		
20. Adjusted Annual Income: Line 6. minus **Line 19**		**$22,190**

Tenant Rent Calculation

1.	**Monthly Income** (Line 6. from Annual Income table ÷ 12)		$1,929
2.	**Monthly Adjusted Income** (Line 20. from Adjusted Income table ÷ 12)		$1,849
3.	**30% of Monthly Adjusted Income** (Line 2. x .30)		$555
4.	**10% of Monthly Income** (Line 1. x .10)		$193
5.	**Welfare Rent** (If applicable)		NA
6.	**Minimum Rent** ($25 for Section 8 / $0 for PAC/PRAC)		$25
7.	**Total Tenant Payment** (greater of Line 3., 4., 5., or 6.) ***Note***: May never exceed unit gross rent in Sec. 8 or PAC programs.		$555
8.	**Utility Allowance** (UA)		$90
9.	**Tenant Rent**: TTP – UA	**a. Tenant Rent:** If positive number, enter	$465
	(Line 7. minus Line 8.)	**b. Utility Reimbursement:** If negative number, enter as positive	$0

Assistance Payment Calculation

1.	**Contract Rent:**	$1,100
2.	**Utility Allowance** (same as Line 8. on Tenant Rent Calc. table)	$90
3.	**Gross Rent** (Line 1. plus Line 2.)	$1,190
4.	**TTP** (same as Line 7. on Tenant Rent Calc. table)	$555
5.	**Assistance Payment:** (Line 3. minus Line 4.)	$635
	5.a. Assistance Payment to Owner for Rent (Lesser of Line 5. or Line 1.)	$635
	5.b. Assistance Payment to Owner for Utility Reimbursement (Line 5. minus Line 5.a.) ***Note***: Should equal **Line 9.b.** on **Tenant Rent Calc**. table	$0

ATTACHMENT E – CASE STUDY 4 ANSWERS

Case Study 4A: The Curly-Q Salon – Under New Management

Return to the Curly-Q Salon, discussed in Case Study 1, and assume that Jackie and Connie are now the co-owners of the business. Because Jackie put in most of the work in building up the business and continues to manage the business day-to-day, they consider their ownership arrangement to be 60% Jackie's business and 40% Connie's business.

Question 1

How would this change your assessment of the net business income to include in Jackie's annual income?

Answer: The net business income would be prorated, and only Jackie's share (60%) would be included in Jackie's annual income calculation. Ideally, Jackie will be able to provide you with documentation showing the 60/40 split that Jackie has reported.

Question 2

Assuming the same calculations of gross business income, business expenses and net business income for the coming year, how much business income from other sources would you include in Jackie's annual income?

Answer: $1,445 (rounded)

You projected $2,408 in business income for Jackie in Case Study 1.

- 2,408 x .60 = **$1,445 (rounded)**

Question 3

a. Jackie tells you that rather than reinvesting the net income in the business, both she and Connie withdrew the money and used it to host a big party for friends, family and clients to celebrate Curly-Q's success in its first year. So, according to Jackie, the actual net income for Curly-Q was zero. Do you count the $1,445 that Jackie withdrew in annual income? Explain your answer.
   - **Yes****
   - No

Explanation: Again, for small business owners, this is where the distinction between personal money and business money can get blurred. Since the business was showing a profit at the end of the year, Jackie and Connie have the right to withdraw this money as a profit. However, Jackie's portion of the withdrawal must also be counted as annual income to Jackie.

b. How might your answer be different if Jackie says that the cost of the party was charged to Curly-Q as an advertising expense?

Answer: Advertising is a legitimate business expense. If the cost of the party is considered a business expense, then the net business income for Curly-Q would be reduced and possibly eliminated, leaving no countable income for Jackie.

Comment: Separating business and personal expenses can be challenging. For example, if Curly-Q were to buy a car for Jackie, she would have to demonstrate that the vehicle was used 100% for business, or count some percentage of the car's cost as personal income.

Question 4

Suppose that Jackie and Connie had miscalculated slightly and withdrew $2,700 for their party, leaving them with a net business loss of $292. Jackie's portion of this loss is $175 ($292 x .60). Can you reduce Jackie's annual income from other sources by this amount? Explain your answer.

a. Yes

b. No**

Explanation: In this instance, the business would have experienced a net loss. However, when net business is negative, it cannot be used to offset other income. Jackie's net income from the business is **$0**, not **negative $175.**

Case Study 4B: A Clean Business

Lance Clean owns a house cleaning business, which just got started this past year. Lance invested $1,500 to get the business going. The gross income for the business was $32,000.

Lance does not receive a regular salary from the business. His intent is to take a profit each quarter – if there is one. Last year Lance did not take any profits from the business, in an effort to get the business going. However, Lance believes his business is improving and he feels he will be safe in taking $2,000 in profits each quarter for the coming year.

Lance employs his 22 year old son Terry Clean, who also lives with the family. Terry works 40 hours a week, and earns $5.50 per hour. This is not expected to change over the coming year.

The business's other expenses in the past year included $10,000 for insurance, equipment, supplies, advertising, and the cost of a part-time bookkeeper. Again, Lance expects these expenses to remain the same for the coming year.

The family has no other sources of income.

Lance provides you with the following breakdown of gross business income for the past year.

Month	Gross Income		
1	$0		
2	$500		
3	$2,000		
4	$2,500		
5	$3,000		
6	$3,100		
6-month Total:		**$11,100**	
6-month Average:			**$1,850/month**
7	$3,000		
8	$3,300		
9	$3,100		
10	$4,000		
11	$3,700		
12	$3,800		
6-month Total:		**$20,900**	
6-month Average:			**$3,483/month**
Annual Total:		**$32,000**	
Annual Average:			**$2,667/month**

Question 1

Based on the information provided, anticipate net business income for the Clean business for the coming year using two approaches. For each approach, explain your answer:

a. **Net Business Income** based on income information from the *entire 12-month period of the previous year*

$2,560

Gross Business Income:		**$32,000**
Terry's salary ($5.50 x 40 x 52):	**$11,440**	
Other business expenses:	**+ $10,000**	
Lance's profit-taking ($2,000 x 4):	**+ $8,000**	
Total Expenses =		**– $29,440**
Net Business Income: ($32,000 – $29,440) =		**$2,560**

Explanation: If we assume no basic changes in gross income or other expenses, the only new expense to the business will be profit-taking by Lance. This would leave new business income of $2,560 for the coming year.

b. **Net Business Income** based on income information from the *most recent 6-month period of the previous year*

$12,360

Gross Business Income ($20,900 x 2)		**$41,800**
Terry's salary ($5.50 x 40 x 52):	**$11,440**	
Other business expenses:	**+ $10,000**	
Lance's profit-taking ($2,000 x 4):	**+ $8,000**	
Total Expenses =		**– $29,440**
Net Business Income: ($41,800 – $29,440) =		**$12,360**

Explanation: Lance's business generated considerably more income in the second half of last year than the first half. If we take the second half of the year and multiply by 2, we get a higher gross income figure for year. Using that higher amount as representative of Lance's projected gross income for the coming year, assuming no basic changes in other expenses, and adding the new expense of profit-taking by Lance, we arrive at a projected net business income of $12,360 for the coming year.

Question 2

From the two methods used in your answer to Question 1, choose the method that seems the most reasonable to you and compute the family's annual income for the coming year. Explain your approach.

Family's annual income for the coming year:	**$30,300**	
Terry's income ($5.50 x 40 x 52):		**$11,440**
Lance's income:		
Lance's profits	**$ 8,000**	
Less initial investment	**– $1,500**	
Net Lance Income =		**+ $6,500**
Net business income =		**+ $12,360**
Annual Income: ($11,440 + $6,500 + $12,360)		**$30,300**

Explanation: It is typical for new businesses to have a slow start. Lance has indicated that he thinks the business is improving. Examining the gross income results from the prior year seems to bear out Lance's optimism about the prospects for improving business income in the coming year. His gross income nearly doubled in the second half of the prior year. Lance is so optimistic that he intends to take some profit income from the business in the coming year.

So, it sounds like things are going pretty well. Given that this is a start-up business, it is likely that the entire gross income from the past year is not a good indicator for the coming year and that the income information from the second half of the year would be more representative of the future prospects for the business. Absent any information to the contrary from Lance, using the second-half of the previous year's information to project ahead for the coming year is a more reasonable approach.

Comment: Any withdrawal of cash or assets from a business is included in annual income, except to the extent that this withdrawal is reimbursement of cash or assets invested by the family. In this instance, Lance invested $1,500 in the business and expects to withdraw $8,000 in profits for the coming year. The first $1,500 of that withdrawal will be reimbursement of cash already invested. The remaining $6,500 will be net profit-taking income for Lance.

Case Study 4C: Earned Income Tax Credit (EITC)

Question 1

At the annual recertification, Kyle reports that he recently received an EITC check for $2,000 and he reports it to you as lump sum income. Kyle also reports that he took his EITC check and opened a new savings account. In the savings account, the money will earn 2% interest over the coming year.

- How much (if any) will you count as income for Kyle, how much (if any) will you count as assets and how much (if any) will you count as income from assets? Explain your answers.

Income	$	**0**
Assets	$	**2000**
Income from Assets	$	**$2,000 x 0.02 = $40**

Explanation: Earned Income Tax Credit (EITC) payments are always excluded from consideration as annual income. So, none of the $2,000 will be counted as income.

Funds in a savings account at an annual recertification are counted as a family asset, regardless of the source of the funds. The regulatory requirements prohibit EITC funds from consideration as income, not assets. So, the full amount of the savings account ($2,000) will be counted as an asset.

Income projected to be earned from an asset is counted as income. In this instance, it is not the EITC funds that are counted as income, but the interest earned from those funds after investment.

Question 2

At the next annual recertification, no mention is made of EITC. However, at the annual recertification for the following year, Kyle reports that he has been receiving an advanced payment of EITC in his weekly paycheck for the past year. Your employment verification form used at the prior recertification did not ask the employer about EITC, nor did the employer offer this information.

- How would you handle this information at this point?

Answer: Earned Income Tax Credit (EITC) payments are always excluded from consideration as annual income.

Since your verification form did not ask specifically about EITC you do not know whether the gross income reported by the employer included the EITC. If the owner followed IRS rules, the EITC would not be included in the gross income reported. However, you do not know this for a fact. You should contact the employer and explicitly confirm the EITC advanced payment in Kyle's weekly paycheck. If this amount is confirmed and verified by the employer, you must ensure that the calculation of Kyle's gross employment income for the coming year does not include the EITC. If the gross income used last year was incorrect because it included the EITC, you must recalculate annual income and rent for the prior year and determine the amount of rent overpaid by Kyle. This amount must be refunded to Kyle.

Comment: A situation such as this should be a clear reminder to add this type of question to the verification form that goes to the employer, and to explicitly include this type of question in any income recertification interview with the tenant family.

ATTACHMENT F – POST-TRAINING SELF TEST ANSWERS

1. Jake and Roberta (and their 3 children) live in your development. Roberta recently inherited an interest in a residential property owned by her grandmother along with her brother and two cousins. Identify at least four things you need to know in order to determine how this inheritance will affect the family's income and rent determinations.

a.	**Roberta's share of the inheritance.**
	Comment: Was ownership in the property divided equally so that Roberta has a 25% share or in some other fashion?
b.	**Cash value of the property.**
	Comment: To determine this, you must know the property's market value, the amount of any outstanding debt on the property, and the likely costs that would be incurred in converting the asset to cash such as broker's fees.
c.	**The amount (if any) of income generated by the property.**
	Comment: For example, is the property occupied by a renter?
d.	**The amount (if any) of expenses expected to be incurred on the property during the next 12 months.**
	Comment: For example, property taxes, utilities, maintenance.
Reference: 4350. 3 REV-1, Exhibit 5-1, Exhibit 5-2A.	

2. Which of the following amounts would you consider a legitimate business expense for Mr. Senoj, a handyman who works out of his apartment in your assisted development (assume that all costs are “reasonable”)? For each “no” or “maybe” answer, explain your answer and what else you might need to know.

		Yes	No	Maybe
a.	$500 paid to his accountant to prepare his income tax.	X		
b.	Interest on a credit card he uses to buy business supplies.	X		
c.	Tickets to a professional football game given as a bonus to his assistant.	X		
d.	The second telephone line installed in the apartment.			X
e.	The amount of depreciation on his truck as indicated by comparing this year's “blue book” value with last year's.			X
f.	The $250 a customer refused to pay for work he had completed.		X	

Explanations:
For item d., in order to count the cost of the second line, Mr. Senoj would have to demonstrate that the need for the second line was business-related, for example the phone line is needed to conduct on-line activities related to the business. Further, if the phone is used partially for business and partially for person activities, the cost of the phone would have to be prorated.
For item e., HUD rules permit only "straight-line" depreciation. A vehicle's actual depreciation on the market could exceed the "straight-line" approach.
For item f., although "bad debts" affect the business's profitability, it is not deducted as an expense because the amount owed would not have been counted in gross income.
Reference: 4350. 3 REV-1, Par. 5-6G., Exhibit 5-1

3. Bill, Betty and their son Benny live in assisted housing. As a result of a traffic accident Benny is disabled. The driver's insurance company set up a nonrevocable trust to cover Benny's medical and care expenses.
   - How should the trust be handled in rent calculations?

Answer: The trust is available to the family only in reimbursement of medical and care expenses for Benny. Therefore, the trust is not considered.
Reference: 4350. 3 REV-1, Par. 5-7G.

4. Mrs. Gimble has recently moved into an assisted development because she can no longer take care of her single-family home. She intends to sell the house but is currently renting the house for $800/month until she does.

   Mr. Gimble (now deceased) bought the house for $40,000 in 1980. The house is now valued at $75,000. A few years ago Mrs. Gimble took out a $10,000 second mortgage to make some repairs to the house. Then, two years ago, she took out another $10,000 loan against the house to help her grandson with college expenses.

   She provides documents that verify the following information about her mortgages and loans:

Loan	Original Balance	Current Balance
1 (original mortgage)	$37,000	$4,800
2 (second mortgage)	$10,000	$5,200
3 (loan)	$10,000	$8,000

She provides documents that verify the following information about the rental of the house:

Rent Received last year:	$8,000
Taxes:	$1,200
Maintenance:	$1,000

a. What asset amount would you include in rent calculations? **$57,000**

Calculated as follows:

$4,800 +5,200+8,000 = $18,000 (outstanding balances on all loans)

$75,000 (house market value) - $18,000 = $57,000 (cash value of house)

b. What gross income from asset would you anticipate related to the house? **$9,600**

Calculated as follows: $800/month (rent) x 12 months = $9,600

Comment: If Mrs. Gimble provides reasons why the unit would not be rented all 12 months the amount could be reduced.

c. What expense items would you deduct from gross income to get net income from this asset?

- **Taxes**
- **Maintenance**
- **Interest on all three loans**

Comment: For taxes, you could use the $1,200 figure, unless documentation of a different amount is available. For maintenance, you could use $1,000 unless documentation of a different amount is available. For interest, you must project the amount of interest to be paid on each loan over the coming year, using an amortization table for each loan.

Reference: 4350. 3 REV-1, Par. 5-7C., Exhibit 5-1, Exhibit 5-2A., Appendix 15-C.L.

5. Mary C. has been living with her son, but now that a unit has become available she is moving into an assisted development. Because her apartment is small and she wants to thank her son for his help she gives him the following:
   - Some of her old furniture worth $5,000
   - Her automobile worth $4,000
   - 3,000 in cash

- How will you treat these gifts when you anticipate Mary's income for the coming year?

Answer: Both the furniture and the automobile are personal property and therefore not considered as assets. But the $3,000 that Mary gave to her son is an asset disposed of for less than fair market value. As such it will be counted as an asset in rent calculations that occur within two years of the gift. **Reference: 4350. 3 REV-1, Par. 5-7G.6., Exhibit 5-1, Exhibit 5-2B.**

6. Ms. Jackson is unemployed and receiving TANF assistance. Last year she received an earned income tax credit of $900.

   - How much EITC income would you anticipate for the coming year? **$0**

Comment: EITC is not counted in the calculation of annual income. In addition, unless circumstances change, it is unlikely that Ms. Jackson will receive EITC next year because it is available only to families with earned income. Ms. Jackson is unemployed. **Reference: 4350. 3 REV-1, Exhibit 5-1**

7. Mrs. Brown sold her house to her son when she moved into assisted housing. The house was valued at $50,000. She sold it to her son for the market price but accepted a $15,000 cash payment that covered the outstanding balance on the mortgage and agreed that her son can pay the remaining balance over time.

   Mrs. Brown's son pays her $500/month on the outstanding loan balance. Of this amount, $492.50 goes to the principal and $7.50 goes to interest. Due to the informal nature of the loan arrangement, there is no amortization schedule and these amounts do not vary over time. You are processing Mrs. Brown's income for the coming 12-month recertification period.

   - What will be the actual annual asset income for this asset over the coming 12-month recertification period? **$90**

Comment: Only the interest portion of the loan payment would be counted as income for Mrs. Brown. Payments on the principal would not be counted as income. In this instance, $7.50/month goes toward interest. $7.50 x 12 = $90 **Reference: 4350. 3 REV-1, Par. 5-7G.5.; Exhibit 5-2A.10.**

8. Sally won $15,000 in the lottery. She decided that this was a good time to save money for her ten year old daughter's higher education. She created a revocable trust that provides her daughter with $3,000 per year while attending college.
   a. How is this trust considered when completing rent and TTP calculations?

Answer: Because Sally still has access to this money (in a revocable trust), the full amount would be considered a family asset and any interest earned would be considered asset income.

   b. Would your answer be any different (if at all) if Sally had established a nonrevocable trust?

Answer: Yes, if Sally had established a nonrevocable trust the asset would be considered an asset disposed of for less than fair market value for a two-year period and after that would not be counted. **Reference: 4350. 3 REV-1, Par. 5-7G.1., Par. 5-7G.6.**

9. Renee and her two children live in your development. The children's grandmother established a nonrevocable trust that provides money for private school for the two girls. The payments are made by a trustee (not Renee) directly to the school.
   - How would this arrangement be treated when calculating income for the family?

Answer: Renee and her children cannot access the trust, so the trust balance does not qualify as an asset to the family. School tuition payments, paid directly to the school, qualify as financial assistance that would be excluded from income.
Reference: 4350. 3 REV-1, Par. 5-6F., Par. 5-7G.1., Exhibit 5-1

10. Mrs. Gray makes regular contributions to the Goodwill Industries.

a. Every year, Mrs. Gray makes a $750 cash donation to Goodwill. Mrs. Gray expects to make this same donation in the coming year as well..

- What amount would you count as an "asset disposed of for less than fair market value?" Explain your answer below.

$1,500

Explanation: If the assets disposed of for less than fair market value exceed $1,000 in any two-year period they must be counted.

In this instance, Mrs. Gray has given $750 every year for the past few years, and expects to do so again in the coming year. So, for the past two-year period only, Mrs. Gray has given $1,500 ($750 x 2).

The total value of assets disposed of for less than fair market value in the preceding two-year period exceeds $1,000. The amount disposed of must be counted as an asset in net family assets.

b. In the past, Mrs. Gray has made $750 cash donation to Goodwill each year. However, for the last couple of years, rather than giving cash, Mrs. Gray has made regular contributions of clothing, canned goods and appliances to Goodwill over the course of the year. Mrs. Gray estimates that these contributions total about the same amount as her prior cash contributions. She expects to take this same approach to contributions in the coming year as well.

- What amount would you count as an "asset disposed of for less than fair market value?" Explain your answer below.

$0

Explanation: Food, clothing and appliances are not generally considered family assets. Therefore, disposal of these items (regardless of their value) would not be considered disposal of family assets.

Reference: 4350. 3 REV-1, Par. 5-7G.6.

NOTES

Trainer Manual

Module 5

Part C: Power Point Presentation