

Introduction to Borrower Income Analysis

January 25, 2024



About this Material

The information presented in these training materials is for general information only. It is based on guidelines and practices generally accepted within the mortgage finance industry and is not intended to be all-inclusive.

The MPF® Provider makes no representations or warranties of any kind with respect to the accuracy, completeness, or suitability of the information contained in this training. In addition, certain information included here speaks only as of the date or dates included in these materials. and the information in the communication may have become out of date.

The MPF Provider expressly disclaims all warranties, express or implied, including without limitation warranties of merchantability and fitness for a particular purpose regarding these materials and our training program. In no event will the MPF Provider be liable for any direct, indirect, incidental, punitive or consequential damages of any kind with respect the training or materials provided.

All examples are hypothetical and are for illustrative purposes only. This training is not intended and should not be interpreted or relied upon as legal advice. We encourage you to seek advice from a qualified professional.

“MPF“, “eMPF” “MPF Xtra” and “eMAQCSplus” are registered trademarks and the “MPF Mortgage Partnership Finance” logo is a trademark of the Federal Home Loan Bank of Chicago.

Presentation Objectives

The purpose of this presentation is to introduce you to the different income types you may encounter when working with borrowers

- **Not an in-depth study of income calculations/scenarios.**
- Important analysis guidelines associated with different income types.
- Documentation needed to analyze the different income types.
- Basic *rules of the road* for analyzing and using various types of income.



Income Sources

- Borrowers receive earnings through many different means.
- To simplify, we are going to break down some of the most common income types into seven categories.

**Non-Variable
Income from
Employment**

**Variable
Income from
Employment**

Self-Employed

Retirement

**Rental
Income**

**Secondary
Employment**

Miscellaneous

Non-Variable Income from Employment

Non-Variable Income

Non-variable income is probably the easiest to understand and calculate as it tends to be consistent

Examples include:

- Borrowers who are paid a salary
- Borrowers paid on an hourly basis, where the number of hours do not fluctuate

Full Documentation

- Pay stubs dated no earlier than 30 days prior to application
- W2s covering the last two years
- Verification of Employment (VOE)
- Verbal VOE (VVOE) no earlier than 10 days before closing

DU or LPA may require

- Pay stubs dated no earlier than 30 days prior to application
- W2 covering the most recent one-year period
- Verification of Employment (VOE)
- Verbal VOE (VVOE) no earlier than 10 days before closing

Non-Variable Income

Most borrowers will receive their pay based on one of these payment schedules

Pay Type	Calculation
Hourly	Hourly rate x number of hours per week x 52 divided by 12
Weekly	Weekly amount x 52 divided by 12
Bi-Weekly	Bi-weekly amount x 26 divided by 12 PAID EVERY 2 WEEKS
Semi-Monthly	Semi-monthly amount x 24 divided by 12 PAID TWICE A MONTH
Annual	Annual salary divided by 12

Avoiding bi-weekly and semi-monthly calculation errors

- **Look at the paycheck date.** Semi-monthly paychecks are commonly dated on the 1st and 15th or the 15th and the last day of the month.
- Divide the gross YTD by the gross base pay for the pay period. That should indicate of how many pay periods there have been YTD.
- *If the YTD pay doesn't support the monthly income, review your determination for frequency of pay.*

There's a Worksheet for That

There are income calculation worksheets available for most of the common income types

- During this session, we'll share worksheets from a variety of sources including Fannie Mae, Freddie Mac, and some of the mortgage insurance providers*

Income Calculation Worksheet (Borrower 1)									
Borrower Name		Gretchen Pierce				Loan Number			
Employer		Harris Accounting Services, Inc.				Date		12/05/2023	
Pay Type									
Hourly		Per Hour				# of hours		X52/12	
		YTD Earnings				# months			
		W2 for Tax Year:				# months			
		W2 for Tax Year:				# months			
		\$0.00		Per Hour		FALSE			
				YTD Avg		FALSE			
				YTD + 1 W2 Avg		FALSE			
				YTD + 2 Yr W2 Avg		FALSE			
		\$0.00		Use lowest income		or check the income you wish to use		If YTD or past year is lower, confirm why. Otherwise, lower of YTD and W2 is required	
								\$0.00	
Salary		Type of Salary							
		Monthly		X1		=		\$0.00	
		Bi Weekly		X26/12		=		\$9,895.88	
		Semi Monthly		X24/12		=		\$0.00	
		Weekly		X52/12		=		\$0.00	
		\$108,854.68		YTD Salary (paystub)		11		# months	
		\$105,345.66		W2 for Tax Year: 2022		12		# months	
		\$101,500.39		W2 for Tax Year: 2021		12		# months	
		\$9,895.88		Base Used to Qualify		check the salary you wish to use		If YTD or past year is lower, confirm why. Otherwise, lower of YTD and W2 is required	
								\$9,895.88	
								\$8,778.81	
								\$8,458.37	

*Using a calculation worksheet is always recommended. We don't endorse one worksheet over another. The examples used in this presentation are just a sampling of some of the worksheets that are readily available. Use what works for you!

Variable Income from Employment

Variable Income

Variable income refers to certain types of income that can fluctuate

- Overtime
 - Commissions
 - Bonuses
 - Hourly pay with no set hours per week
 - Shift differentials
 - Part-time work that varies
- Can you name some common types of variable income?

Variable Income

Borrowers must have a history of receiving variable income

- Typically, a two-year look back is required
 - Less than a 24-month history may be permitted if there are strong supporting factors.
 - At no time should less than a 12-month history be utilized.
- Is the income increasing, decreasing, or relatively unchanged?
- If the income has fluctuated more than 10% year to year, additional analysis is always recommended.

Typical documentation needed to calculate variable income

- Recent pay stub(s)
- Last 2 years of W2s
- VOE
- VVOE

Variable Income

If the income has increased:

- Average the income

2022 = \$47,502
2023 = \$ 52,323
 $\$99,825 \div 24 = \$4,159.$ per month

If the income was declining **but has since stabilized** and there's no reason to believe the borrower will not continue to be paid at the current level:

- The current lower amount should be used. **Do not average.**

2022 = \$65,210
2023 = \$ 41,630
 $\$41,630 \div 12 = \$3,469$ per month

If the income has declined, the income may not be stable. Additional analysis is needed to determine if any of the income can be used.

- Under no circumstances can the income be averaged over the period when the decline occurred.

⚠ CAUTION

Variable Income Worksheet Example

A simple example of analyzing bonus income

- Verifications of Income (VOE) will usually break down bonus amounts.

12B. Gross Earnings			
Type	Year To Date	Past Year	Past Year
Base Pay	Thru \$	\$	\$
Overtime	\$	\$	\$
Commissions	\$	\$	\$
Bonus	\$	\$	\$
Total	\$ 0.00	\$ 0.00	\$ 0.00

Section 12 B of Fannie Mae/Freddie Mac VOE

Borrower(s) Name

Paul Revere

Loan Number:

Previous Years Bonus Analysis

Year:

20 23

20 22

Most Recent Year

Prior Year

Total Bonus Earned

\$ 8,500.00

\$ 7,850.00

% Change (Negative Number represents a decrease)

8%

Year to Date Income Analysis (Most Recent Year vs. YTD)

Year to Date Bonus

\$ -

Bonus Payout Months

12 (default) = annual

6 = bi-annual

4 = quarterly

% Change (Negative Number represents a decrease)

n/a

Monthly Qualifying Income

Select the methodology you'd like to use for calculating the monthly qualifying income from the dropdown

Prior Year + Most Recent Year + YTD

Monthly Qualifying Bonus Income

\$ 454.17

Users can manually override the monthly qualifying income calculation by entering the number of months to average the income over in this field; the Underwriter should indicate in the notes section their reasoning for manually adjusting the calculation

Adjusted Monthly Qualifying Bonus Income

#DIV/0!

Notes

Bonus is received every December. Used 2022 and 2023 bonuses

Self-Employed Income

Self-Employed Business Structures

There are five principal self-employed categories

**Sole
Proprietorships**

Partnerships

**Limited Liability
Companies (LLCs)**

S Corporations

Corporations

General Self-Employed Income Reminders

- Business income (specifically from a partnership or S corporation) reported on a borrower's personal tax return may not necessarily represent income that has been distributed to the borrower.
- If a borrower owns multiple businesses, tax returns for each of those businesses must be provided.
- If business or personal returns have not been filed prior to the deadline (April 15th), the tax extension form must be provided.

The following factors should be analyzed:

- *Is the borrower's income stable?*
- *What is the location and nature of the borrower's business?*
- *Is there a demand for the business's product or services?*
- *How is the financial strength of the business?*
- *Can the business continue to generate and distribute sufficient income to the borrower?*



Sole Proprietorships

- Unincorporated business that is individually owned and managed.
- The owner is responsible for all debts of the business.
- There is no distinction between the owner's personal assets and the assets used in the business.
- Income and expenses are reported on **Schedule C** of the borrower's IRS Form 1040.



Schedule C Example

**SCHEDULE C
(Form 1040)**

Profit or Loss From Business

(Sole Proprietorship)

OMB No. 1545-0074

2023

Attachment
Sequence No. **09**

Department of the Treasury
Internal Revenue Service

Attach to Form 1040, 1040-SR, 1040-SS, 1040-NR, or 1041; partnerships must generally file Form 1065.
Go to www.irs.gov/ScheduleC for instructions and the latest information.

Name of proprietor

Rebecca C. Glazer

Social security number (SSN)

A Principal business or profession, including product or service (see instructions)

Ceramist

B Enter code from instructions

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

D Employer ID number (EIN) (see instructions)

RCG Pottery

E Business address (including suite or room no.) 123 Fake Street

City, town or post office, state, and ZIP code Nowhere, IL 11111

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

G Did you "materially participate" in the operation of this business during 2023? If "No," see instructions for limit on losses.

☐ Yes ☒ No

H If you started or acquired this business during 2023, check here:

☐ Yes ☒ No

I Did you make any payments in 2023 that would require you to file Form(s) 1099? See instructions.

☐ Yes ☒ No

J If "Yes," did you or will you file required Form(s) 1099?

☐ Yes ☒ No

Part I Income

1	Gross receipts or sales. See instructions for line 1 and check the box if this income was reported to you on Form W-2 and the "Statutory employee" box on that form was checked.	1	12,452
2	Returns and allowances.	2	
3	Subtract line 2 from line 1.	3	
4	Cost of goods sold (from line 42).	4	
5	Gross profit. Subtract line 4 from line 3.	5	
6	Other income, including federal and state gasoline or fuel tax credit or refund (see instructions).	6	
7	Gross income. Add lines 5 and 6.	7	12,452

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

8	Advertising.	8	250	18	Office expense (see instructions).	18	
9	Car and truck expenses (see instructions).	9		19	Pension and profit-sharing plans.	19	
10	Commissions and fees.	10		20	Rent or lease (see instructions):	20	
11	Contract labor (see instructions).	11		a	Vehicles, machinery, and equipment	20a	753
12	Depletion.	12		b	Other business property.	20b	
13	Depreciation and section 179 expense deduction (not included in Part III) (see instructions).	13	1280	21	Repairs and maintenance.	21	
14	Employee benefit programs (other than on line 19).	14		22	Supplies (not included in Part III).	22	3317
15	Insurance (other than health).	15		23	Taxes and licenses.	23	
16	Interest (see instructions):	16		24	Travel and meals:	24	
a	Mortgage (paid to banks, etc.).	16a		a	Travel.	24a	
b	Other.	16b		b	Deductible meals (see instructions).	24b	
17	Legal and professional services.	17		25	Utilities.	25	
28	Total expenses before expenses for business use of home. Add lines 8 through 27b.	28		26	Wages (less employment credits).	26	5600
29	Tentative profit or (loss). Subtract line 28 from line 7.	29		27a	Other expenses (from line 48).	27a	6852
30	Expenses for business use of your home. Do not report these expenses elsewhere. Attach Form 8829 unless using the simplified method. See instructions.	30		b	Energy efficient commercial bldgs deduction (attach Form 7205).	27b	

Simplified method (see instructions). Enter the total square footage of (a) your home:

and (b) the part of your home used for business. Use the Simplified

Method Worksheet in the instructions to figure the amount to enter on line 30.

31 Net profit or (loss). Subtract line 30 from line 29.

• If a profit, enter on both **Schedule 1 (Form 1040)**, line 3, and on **Schedule SE**, line 2, if you checked the box on line 1, see instructions.) Estates and trusts, enter on **Form 1041**, line 3.

• If a loss, you **must** go to line 32.

32 If you have a loss, check the box that describes your investment in this activity. See instructions.

• If you checked 32a, enter the loss on both **Schedule 1 (Form 1040)**, line 3, and on **Schedule SE**, line 2, if you checked the box on line 1, see line 31 instructions.) Estates and trusts, enter on **Form 1041**, line 3.

• If you checked 32b, you **must** attach **Form 6198**. Your loss may be limited.

32a ☐ All investment is at risk.

32b ☐ Some investment is not at risk.

For Paperwork Reduction Act Notice, see the separate instructions.

Cat. No. 11334P

Schedule C (Form 1040) 2023

[illegible]

Sole Proprietorships: Documentation

Documentation typically required to analyze sole proprietors:

- Last two years of signed 1040s; or
- The most recent signed 1040 (if DU or LPA findings permit).
- **NOTE:** YTD profit and loss statements (P&Ls) are generally used to demonstrate patterns or provided additional insight. Only audited P&L statements can be used in the actual income calculation.

	Most Recent Year		Prior Year									
	20	23	20	22								
Analysis of Schedule C Income - Schedule Analysis Method												
1 Net Profit or (Loss)	\$56,730.00		\$49,669.00									
2 Non-Recurring Other (Income) Loss/Expense	\$18,784.00		\$16,541.00									
3 Depletion	\$0.00		\$0.00									
4 Depreciation	\$4,760.00		\$6,786.00									
5 Meals and Entertainment Exclusion	(\$0.00)		(\$0.00)									
6 Business Use of Home	\$0.00		\$0.00									
7 Amortization/Casualty Loss/One-Time Expenses	\$0.00		\$0.00									
8 Mileage Depreciation	<table><tr><th>Business Miles</th><th>Dep. Rate</th></tr><tr><td>0</td><td>0</td></tr></table>	Business Miles	Dep. Rate	0	0	<table><tr><th>Business Miles</th><th>Dep. Rate</th></tr><tr><td>0</td><td>0</td></tr></table>	Business Miles	Dep. Rate	0	0	\$0.00	
Business Miles	Dep. Rate											
0	0											
Business Miles	Dep. Rate											
0	0											
9 Annual Total	\$80,274.00		\$72,996.00									
10 Monthly Qualifying Income If Averaging Most Recent Year	\$6,689.50											
Monthly Qualifying Income If Averaging Two Years	\$6,386.25											

Borrower Name:
Gail Spaulding

Comments:
Averaging 2022 and 2022.

Partnerships

Partnerships are unincorporated businesses where two or more parties jointly manage and operate a company

Any individual who has a 25% or greater ownership interest in a business is considered self-employed.

- Partnerships do not pay income taxes. Profits and losses are passed on to its partners and reported on the borrower's personal tax returns.
- The partnership reports profits/losses on IRS Form 1065 and each partner's share of the profit/loss is provided on Form 1065, Schedule K-1.
- Two years of both personal and business tax returns are typically required.

Schedule K-1 (Form 1065) 2023
 Department of the Treasury
 Internal Revenue Service

Part III Partner's Share of Current Year Income, Deductions, Credits, and Other Items

Part I Information About the Partnership

Part II Information About the Partner

J Partner's share of profit, loss, and capital (see instructions):

	Beginning	Ending
Profit	30 %	30 %
Loss	30 %	30 %
Capital	30 %	30 %

Check if decrease is due to:
☐ Sale or ☐ Exchange of partnership interest. See instructions.

K1 Partner's share of liabilities:

	Beginning	Ending
Nonrecourse	\$	\$
Qualified nonrecourse financing	\$	\$
Recourse	\$	\$

K2 Check this box if item K1 includes liability amounts from lower-tier partnerships ☐

K3 Check if any of the above liability is subject to guarantees or other payment obligations by the partner. See instructions ☐

Partnerships

There are two main types of partnerships that utilize Form 1065 and K-1s

General Partnership

- The partners are each personally liable for the partnership debts
- Partners usually have a role in running the business



Limited Partnership

- The partners' liability for the business debts is limited to the amount of money or property the partner contributed
- Partners usually don't participate in the management of the business



Partnership Documentation

- The most recent 2 years of signed individual federal tax returns (1040's) and the corresponding Form 1065s and K-1s; or
- The most recent signed 1040 and corresponding Form 1065 and K-1 (if DU or LPA findings permit).
- 2 years of business tax returns*
- YTD profit and loss statement may be used in some cases but cannot be used in the income analysis unless it has been audited.

*This may not apply in certain situations when DU or LPA are used.

IRS Form 1065 and K-1: Using a Worksheet

- This is an example from an income analysis worksheet showing the section for partnership income.
- Both IRS Form 1065 and Schedule K-1 are broken out on the worksheet.

Partnership or S Corporation

A self-employed borrower's share of Partnership or S Corporation earnings can only be considered if the lender obtains documentation, such as Schedule K-1, verifying that

- the income was actually distributed to the borrower, or
- the business has adequate liquidity to support the withdrawal of earnings. If the Schedule K-1 provides this confirmation, no further documentation of business liquidity is required.

Note: See the Instructions for additional guidance on documenting access to income and business liquidity.

IRS Form 1065 - Partnership Income

	Year _____	Year _____
7. Schedule K-1 Form 1065 – Partner's Share of Income		
a. Ordinary Income (Loss)	(+/-) _____	(+/-) _____
b. Net Rental Real Estate; Other Net Income (Loss)	(+/-) _____	(+/-) _____
c. Guaranteed Payments to Partner	(+) _____	(+) _____
8. Form 1065 - Adjustments to Business Cash Flow		
a. Ordinary (Income) Loss from Other Partnerships	(+/-) _____	(+/-) _____
b. Nonrecurring Other (Income) Loss	(+/-) _____	(+/-) _____
c. Depreciation	(+) _____	(+) _____
d. Depletion	(+) _____	(+) _____
e. Amortization/Casualty Loss	(+) _____	(+) _____
f. Mortgages or Notes Payable in Less than 1 Year	(-) _____	(-) _____
g. Non-deductible Travel and Entertainment Expenses	(-) _____	(-) _____
h. Subtotal	_____	_____
i. Total Form 1065 (Subtotal multiplied by % of ownership)	_____	_____

Limited Liability Company (LLC)

- LLCs are a legal business structure that protects the owner's personal assets from the company's debts. There is a financial barrier between the company and the owner.
- Can be owned by a single-member or multiple members.
- LLCs can elect to file taxes as an S corporation.
- Instead of IRS Form 1065, LLC income/losses may be reported on **IRS Form 1120-S**, and partners are supplied with a K-1.

Schedule K-1 (Form 1120-S)
Department of the Treasury
Internal Revenue Service
For calendar year 2022, or tax year

beginning / / 2022 ending / /

Shareholder's Share of Income, Deductions, Credits, etc.

Part I Information About the Corporation

A Corporation's employer identification number

B Corporation's name, address, city, state, and ZIP code

C IRS Center where corporation filed return

D Corporation's total number of shares
Beginning of tax year
End of tax year

E Shareholder's identifying number

F Shareholder's name, address, city, state, and ZIP code

G Current year allocation percentage %

H Shareholder's number of shares
Beginning of tax year
End of tax year

I Loans from shareholder
Beginning of tax year \$
End of tax year \$

Part II Information About the Shareholder

1 Ordinary business income (loss)

2 Net rental real estate income (loss)

3 Other net rental income (loss)

4 Interest income

5a Ordinary dividends

5b Qualified dividends

6 Royalties

7 Net short-term capital gain (loss)

8a Net long-term capital gain (loss)

8b Collectibles (28%) gain (loss)

8c Unrecaptured section 1250 gain

9 Net section 1231 gain (loss)

10 Other income (loss)

11 Section 179 deduction

12 Other deductions

13 Credits

14 Schedule K-1 is attached if checked

15 Alternative minimum tax (AMT) items

16 Items affecting shareholder basis

17 Other information

18 More than one activity for at-risk purposes?

19 More than one activity for passive activity purposes?

* See attached statement for additional information.

Form 1120-S U.S. Income Tax Return for an S Corporation
OMB No. 1545-0123
2023

Do not file this form unless the corporation has filed or is attaching Form 2553 to elect to be an S corporation.
Go to www.irs.gov/Form1120S for instructions and the latest information.

For calendar year 2023 or tax year beginning 2023, ending 20

A S election effective date

B Business activity code number (see instructions)

C Check if box M-3 attached

D Employer identification number

E Date incorporated

F Total assets (see instructions)

G Is the corporation electing to be an S corporation beginning with this tax year? See instructions. Yes No

H Check if: (1) Final return (2) Name change (3) Address change (4) Amended return (5) S election termination

I Enter the number of shareholders who were shareholders during any part of the tax year

J Check if corporation: (1) Aggregated activities for section 469 passive activity purposes (2) Grouped activities for section 469 passive activity purposes

Caution: Include only trade or business income and expenses on lines 1a through 22. See the instructions for more information.

Income

1a Gross receipts or sales

2 Cost of goods sold (attach Form 1125-A)

3 Gross profit. Subtract line 2 from line 1a

4 Net gain (loss) from Form 4797, line 17 (attach Form 4797)

5 Other income (loss) (see instructions—attach statement)

6 **Total income (loss).** Add lines 3 through 5

Deductions (see instructions for limitations)

7 Compensation of officers (see instructions—attach Form 1125-E)

8 Salaries and wages (less employment credits)

9 Repairs and maintenance

10 Bad debts

11 Rents

12 Taxes and licenses

13 Interest (see instructions)

14 Depreciation from Form 4562 not claimed on Form 1125-A or elsewhere on return (attach Form 4562)

15 Depletion (Do not deduct oil and gas depletion.)

16 Advertising

17 Pension, profit-sharing, etc., plans

18 Employee benefit programs

19 Energy efficient commercial buildings deduction (attach Form 7205)

20 Other deductions (attach statement)

21 **Total deductions.** Add lines 7 through 20

22 **Ordinary business income (loss).** Subtract line 21 from line 6

Tax and Payments

23a Excess net passive income or LIFO recapture tax (see instructions)

23b Tax from Schedule D (Form 1120-S)

23c Add lines 23a and 23b (see instructions for additional taxes)

24a Current year's estimated tax payments and preceding year's overpayment credited to the current year

24b Tax deposited with Form 7004

24c Credit for federal tax paid on fuels (attach Form 4136)

24d Elective payment election amount from Form 3800

24e Add lines 24a through 24d

25 Estimated tax penalty (see instructions). Check if Form 2220 is attached

26 Amount owed. If line 24e is smaller than the total of lines 23c and 25, enter amount owed

27 Overpayment. If line 24e is larger than the total of lines 23c and 25, enter amount overpaid

28 Enter amount from line 27: Credited to 2024 estimated tax Refunded

Sign Here

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

Signature of officer Date Title

Print/Type preparer's name Preparer's signature Date

Firm's name Firm's EIN

Firm's address Phone no.

For Paperwork Reduction Act Notice, see separate instructions. Cat. No. 11510H Form 1120-S 2023

S-Corporations

- Doesn't pay corporate income tax like a traditional corporation.
- Profits pass through to the shareholder's personal tax returns.
- Like partnerships, K-1s are issued to shareholders.
- Corporation income/loss is reported on **IRS Form 1120S and K-1s**.
- This example shows the 1120S and K-1 sections from an income calculation worksheet.

III. Income Calculations from IRS Schedule K-1 and IRS Form 1120S

9. S Corporation Income (Refer to Chapter 5304)

Name of business: _____

S Corporation Schedule K-1 (IRS Form 1120S)	Year:	Year:
Ordinary Business Income or Loss	(+/-)	(+/-)
Net rental real estate income or loss	(+/-)	(+/-)
Subtotal from Schedule K-1 (IRS Form 1120S)	\$	\$

S Corporation Income from IRS Form 1120S	Year:	Year:
Depreciation (IRS Form 1120S)	(+)	(+)
Depreciation (IRS Form 8825) (Guide Section 5304.1(d))	(+)	(+)
Depletion	(+)	(+)
Amortization or casualty loss	(+)	(+)
Mortgage, notes, bonds payable in less than one year (Section 5304.1(d))	(-)	(-)
Other nonrecurring income or loss	(+/-)	(+/-)
Travel and entertainment exclusion	(-)	(-)
Subtotal prior to application of ownership interest percentage	\$	\$
Multiply by total percentage of ownership (on Schedule K-1)	(x) 0.00%	(x) 0.00%
Subtotal from IRS Form 1120S	\$	\$

Combined subtotal from S corporation	\$	\$
---	----	----

C Corporations (C Corp or Regular Corporation)

- Corporations offer the strongest protection to its owners from personal liability, but the cost to form a corporation is higher than other structures.
- Can be created by an individual or a group of people.
- Corporations report income and losses on IRS 1120 and pay taxes on net income.
- Both the corporation and its shareholders pay taxes on business profits.
- Shareholders may receive IRS Form 1099-DIV or a W2*. Those earnings are reported on their personal tax returns.

*Those receiving W2s should also have paystubs available.

IRS Form 1120 – Regular Corporation		
Corporation earnings may be used when the borrower(s) own 100% of the corporation.		
	Year _____	Year _____
11. Form 1120 – Regular Corporation		
a. Taxable Income	_____	_____
b. Total Tax	(-) _____	(-) _____
c. Nonrecurring (Gains) Losses	(+/-) _____	(+/-) _____
d. Nonrecurring Other (Income) Loss	(+/-) _____	(+/-) _____
e. Depreciation	(+) _____	(+) _____
f. Depletion	(+) _____	(+) _____
g. Amortization/Casualty Loss	(+) _____	(+) _____
h. Net Operating Loss and Special Deductions	(+) _____	(+) _____
i. Mortgages or Notes Payable in Less than 1 Year	(-) _____	(-) _____
j. Non-deductible Travel and Entertainment Expenses	(-) _____	(-) _____
k. Subtotal	_____	_____
l. Less: Dividends Paid to Borrower	(-) _____	(-) _____
m. Total Form 1120	_____	_____

Self-Employed Borrower Documentation Requirements

Documentation guidance for borrowers with 25% or more interest in a business

Self-Employed Business Type	General Documentation Requirements	Calculation Worksheets Use
Sole Proprietor	<ul style="list-style-type: none">Last two years of IRS 1040s	Schedule C
General or Limited Partnership	<ul style="list-style-type: none">Last two years of IRS 1040sLast two year of business returns	IRS Form 1065 and K-1s
Limited Liability Company (LLC)	<ul style="list-style-type: none">Last two years of IRS 1040sLast two years of business returns	IRS Form 1120-S and K-1s
S Corporation (S Corp)	<ul style="list-style-type: none">Last two years of IRS 1040sLast two years of business returns	IRS Form 1120-S
Corporation (C Corp)	<ul style="list-style-type: none">Last two years of IRS 1040sLast two years of business returns	IRS Form 1120

- DU or LPA may request/require less than two years of tax returns in some cases.
- When using DU or LPA, business returns may be waived if all the following apply: Two years of signed, person tax returns must be provided, the borrower must be using personal funds for down payment and/or closing costs, the borrower has been self-employed in the same business for at least 5 years and the borrower's personal tax returns show an increase in self-employed income over the past two years.

Retirement

Retirement Income Sources

Retirement Income can come in many different forms.

Examples include:

- Social Security
- Pensions
- IRA, 401K, and Keogh Distributions
- Government Annuities or Pensions



Retirement Income Documentation

Social Security Retirement Income

Documentation

- A SSA Award Letter, SSA Form 1099, or proof of receipt can be used to verify Social Security.

Grossing-up untaxed Social Security income

- If grossing-up more than 15% of the borrower's Social Security income, tax returns are required to confirm the non-taxable amount.
- **15%** of the borrower's Social Security income may be treated as non-taxable and grossed up by 25% without the need for tax returns.



Retirement Accounts/Pensions/Government Annuities

Income from IRAs, 401(k)s or Keogh Retirement Accounts

One or more of the following may be used to document receipt:

- A statement from the organization providing the income, benefit statement, bank account statement, tax return, IRS W2, or IRS 1099.
- **Is it eligible?**
- The income must continue for at least three years after the date of the mortgage application.
- Accounts may be combined for the purpose of determining whether the three-year continuance requirement is met.



Creating Income Streams from Retirement Assets

Some borrowers have retirement assets such as 401Ks or IRAs, but have never taken any distributions

- If the borrower is eligible, an income stream can be created from those assets.
- Maximum LTV is **70%**
- If the borrower is 62 years old or more, the maximum LTV is **80%**. If owned jointly with the co-borrower, both borrowers must be at least 62 years old.
- Purchases and limited cash-out refinances only.
- Principal residence and second homes only.
- The asset must be in the borrower's name as an individual or jointly with only a co-borrower.

INCOME STREAM EXAMPLE

Value of the Asset	\$400,000
Penalties that may apply	-\$40,000
Funds being used for closing	-\$50,000

Net Documented Asset \$310,000

Divide the Net Documented Asset by the loan term

$$\$310,000 \div 360 = \textbf{\$861.11/ month}$$

Rental Income

Rental Income

Borrowers can earn rental income from several sources

- Personally held investment properties
- A primary, owner-occupied 2–4-unit property
- Properties owned through a business

Documentation typically used to analyze rental income may include:

- **Schedule E** on IRS Form 1040
- **Leases** (used only in certain situations, such as when the property is newly acquired and not on the tax return, or purchases where the property is income-producing.
- Business returns such as IRS Form 1065 or 1120S.

Analyzing Rental Income

Many rental income worksheets are specific to the occupancy or documentation used to calculate the income/loss

- Principal Residence, 2-4-unit property (Fannie Mae Form 1037),
- Individual Rental Income from Investment Property(s) (up to 4 properties) (Fannie Mae Form 1038),
- Individual Rental Income from Investment Property(s) (up to 10 properties) (Fannie Mae Form 1038A)
- Business Rental Income from Investment Property(s) (Fannie Mae Form 1039).

Documentation

- For properties currently owned (Schedule E), use the borrower's most recent tax returns. Do not average over two years.
- For new properties (purchases or properties acquired in the last tax year), leases or market rents from an appraisal may be used.
- When using leases or market rents, **75% of the gross rents** should be used. The reduction accounts for potential expenses and vacancies.

Fannie Mae's Form 1038

Rental Income Worksheet						
Individual Rental Income from Investment Property(s): Monthly Qualifying Rental Income (or Loss)						
Documentation Required:		Enter	Investment Property Address	Investment Property Address	Investment Property Address	Investment Property Address
<ul style="list-style-type: none"> Schedule E (IRS Form 1040) OR Lease Agreement or Fannie Mae Form 1007 or Form 1025 						
Step 1. When using Schedule E, determine the number of months the property was in service by dividing the Fair Rental Days by 30. <i>If Fair Rental Days are not reported, the property is considered to be in service for 12 months unless there is evidence of a shorter term of service.</i>						
Step 1. Result: Enter the number of months the property was in service:		Result				
Step 2. Calculate monthly qualifying rental income (loss) using Step 2A: Schedule E OR Step 2B: Lease Agreement or Fannie Mae Form 1007 or Form 1025.						
Step 2A. Schedule E - Part I For each property complete ONLY 2A or 2B						
A1	Enter total rents received.	Enter				
A2	Enter total expenses.	Subtract				
A3	Enter insurance expense.	Add				
A4	Enter mortgage interest paid.	Add				
A5	Enter tax expense.	Add				
A6	Enter homeowners' association dues. <i>This expense must be specifically identified on Schedule E in order to add it back.</i>	Add				
A7	Enter depreciation expense or depletion.	Add				
A8	Enter any one-time extraordinary expense (e.g., casualty loss). <i>There must be evidence of the nature of the one-time extraordinary expense.</i>	Add				
	Equals adjusted rental income.	Total	0	0	0	0
A9	Enter the number of months the property was in service (Step 1 Result).	Divide	0	0	0	0
	Equals adjusted monthly rental income	Total	0	0	0	0
A10	Enter proposed PITIA (for subject property) or existing PITIA (for non-subject property).	Subtract				
	Step 2A. Result: Monthly qualifying rental income (or loss):	Result	0	0	0	0

Step 2B. Lease Agreement OR Fannie Mae Form 1007 or Form 1025 For each property complete ONLY 2A or 2B					
This method is used when the transaction is a purchase, the property was acquired subsequent to the most recent tax filing, or the lender has justification for using a lease agreement.					
B1	Enter the gross monthly rent (from the lease agreement) or market rent (reported on Form 1007 or Form 1025). <i>For multi-unit properties, combine gross rent from all rental units.</i>	Enter			
B2	The remaining 25% accounts for vacancy loss, maintenance, and management expenses.	Multiply	x.75	x.75	x.75
	Equals adjusted monthly rental income.	Total	0	0	0
B3	Enter proposed PITIA (for subject property) or existing PITIA (for non-subject property).	Subtract			
	Step 2B. Result: Monthly qualifying rental income (loss):	Result	0	0	0
Step 3. Determine the qualifying impact using the result of Step 2A or Step 2B.					
If the result of Step 2A or 2B is positive , add the positive amount to the borrower's monthly qualifying income. <i>Because the PITIA expense was included in the calculations above, do not add it to the debt-to-income (DTI) ratio.</i>					
If the result of Step 2A or 2B is negative , include the amount of the loss in the borrower's monthly expenses when calculating the DTI ratio.					
DU Data Entry	Monthly Income and Combined Housing Expenses		Mortgage Liabilities		
Subject Property	Enter the amount of the monthly qualifying income (positive result) or monthly qualifying loss (negative result) in "Subject Net Cash."		For refinance transactions, identify the mortgage as a subject property lien.		
Non-Subject Property	Enter the amount of the monthly qualifying income (positive result) or monthly qualifying loss (negative result) in "Net Rental."		Identify the mortgage as a rental property lien.		
Refer to the Rental Income topic in the Selling Guide for additional guidance.					

Secondary Employment

Secondary Employment

Many borrowers may have second jobs to supplement their income

- At least a two-year history of secondary employment is recommended.
- Less than two years (but never less than 12 months) may be acceptable, if there are positive factors to reasonably offset the shorter income history.
- Secondary employment can oftentimes fluctuate based on hours. In this case, variable income guidelines should be followed.
- A history of different employers is acceptable as long as employment is consistent.



Secondary Employment

Secondary employment can also include income received through self-employment

“Gig-work” is a common term used for some secondary self-employment.

Many gig-workers may receive a 1099-NEC from an organization instead of a W2 because they are not an employee of the company (think UBER). This income is reported on their Schedule C.

If a borrower qualifies using only base pay from their primary employment, secondary income/losses may be disregarded.

- **This is not permitted if the borrower’s primary income is derived from self-employment.**



Miscellaneous Sources

Common Types of Miscellaneous Income

Alimony, Child Support, Separate Maintenance

- Alimony, child support, or separate maintenance must continue to be paid for at least three years after the date of the mortgage application.
- Document using a copy of a divorce decree or separation agreement.
- Evidence receipt of payments covering no less than the previous six months.

Seasonal Unemployment

- The borrower must have at least a two-year history of receiving seasonal unemployment income.
- The unemployment income should be associated with seasonal layoffs, expected to recur, and the income reported on the borrower's signed federal income tax returns.

Capital Gains

- Typically, capital gains are a one-time payment and cannot be used.
- If capital gains are recurring, a two-year history must be documented (Schedule D, IRS 1040s).
- Verify the asset(s) supporting the gain.
- Use the variable income guidelines for calculating.
- Capital losses do not have to be held against the borrower.

Automobile Allowances

Payments must have been received for at least 2 years.

Add the full amount of the allowance to the borrower's monthly income.

If the borrower has a lease or car loan, treat it like any other liability.

Summary

Borrower income can sometimes be complicated and difficult to understand.

If something doesn't make sense, don't be afraid to reach out to the borrower for additional insight.

Worksheets are great tools for breaking down income. Always show your calculations!

Sometimes more analysis beyond a worksheet/documentation will be necessary.

Looking for more detail? The MPF Program and many mortgage insurance companies provide webinars on analyzing specific types of income.

MPF® Program Contacts and Resources

MPF Service Center

Email: MPF-Help@FHLBC.com

Hours: 8:30 am to 4:30 pm CST

Phone: (877) 345-2673

The MPF Customer Service Portal is also a great way to get answers to your questions!



MPF National Education



Check out our upcoming webinars:

<https://www.fhlbmpf.com/education/upcoming-webinars>

Register for MPF University

www.fhlbmpf.com

We appreciate your feedback. Contact MPF National Education with any requests or suggestions!

mpftraining@fhlbc.com

**Follow the MPF Program on
Social Media!**

