



Best Practices for Income Documentation

Acceptable Sources of Income

Wage Earner Income: All non-self-employed borrowers who receive a W-2 at year end must provide the W-2 as evidence of total earnings – includes hourly, weekly, biweekly, part-time, seasonal, bonus, commission, and tips/gratuity.

Non-Employment Income: Acceptable documentation of the following must be provided. Alimony/ Maintenance/Child Support/ Separate Maintenance, Foster Care, Unemployment/Welfare/ADC, Disability/Worker's Compensation, Retirement/Pension, Social Security, Annuity, IRA, Military/VA Benefits, Trust, Interest & Dividend, Inheritance/Guaranteed Income, Note Receivables, Mortgage Differential/COLA, and Rental.

Reminder: All income used to qualify must be documented in the loan file. Income from sources other than the ones addressed above may be considered provided the borrower has received the income for at least 2 years and documentation supports that it will continue for at least 3 years.

Unacceptable Sources of Income

Income derived from any of the following may not be used in calculating qualifying income:

- Income based on future earnings
- Draw Income
- Capital withdrawals
- Expense/Auto Reimbursement
- VA Education Benefits
- Illegal Income/Income not listed on Tax Returns
- Any income that cannot be documented and verified
- Room/boarder rent from subject property (except for special circumstances)
- Trailing Co-Borrower

Wage Earner Income Calculation

Hourly: Hourly Rate x # of Hours x 52 weeks / 12 = Monthly Base Income

Weekly: Weekly Base Salary x 52 weeks / 12 = Monthly Base Income

Biweekly: Biweekly Base Salary x 26 weeks / 12 = Monthly Base Income

Semi-Monthly: Semi-Monthly Base Pay x 24 weeks / 12 = Monthly Base Income

Monthly: Monthly Base Pay as shown (without overtime, bonus or commissions)

Annually: Annual rate of pay (without overtime, bonus, commissions) /12 = Monthly Base Income

Reminder: The actual calculation used to determine the qualifying income must be documented in every loan file.

Overtime Income

In order to use overtime income to qualify there must be a two year history of receiving it; it must be consistent with the prior years' earnings, and expected to continue.

Rental Income Categories

If the amount is positive, it is added to the qualifying income.

If the amount is negative, it is added to the recurring debts.

Reminder: On existing leases or rentals, it is required to provide the agreement on the subject property to verify terms meet all investor guidelines.

IRS Form 4506-T

A signed 4506-T is required on all loans. All borrowers must sign this form at application and again at closing. The signed 4506-T must be processed for all borrowers when tax returns are used to calculate income and the IRS transcripts must be obtained for the most recent two years available, or most recent year if only one years' tax return is required per the AUS finding, prior to final approval.

Additional Helpful Reminders

Ensure the most recent tax year W-2 is submitted; validate the W-2 supports the income used in the calculation.

A **two-year** employment history must be reviewed to assure the borrower has a history of receiving stable income from employment.

The broker must obtain the most recent paystub showing income on the date of application. A K-1 loss (Schedule E) must be included in income calculation.

Possible exception to use reimbursed expenses as part of the income calculation must include verification from employer that expenses incurred by borrower were reimbursed, will continue and are not listed on Form 2106.

Ensure the paystub supports a consistent 40-hour week before calculating income at 40 hours/week.

The social security income cannot be grossed up if borrower's annual income is more than \$25,000 individually; non-taxable income can be grossed up 25% provided it is verified as non-taxable.

An explanation is required from employer when there is a decrease in income.
Family Owned Businesses providing Income: There must be a written confirmation from legal counsel regarding ownership of a family-owned business and provide two years of business returns in the file. Any business losses must be factored into a borrower's qualifying income.

Income Calculation - Self-Employed Borrower(s)

Sole Proprietorship, Partnership, Corporations, and S Corporations are acceptable sources of income.

If either the borrower or co-borrower is self-employed, in addition to the required wage earner income documentation, personal tax returns must be provided even if the income is not being used to qualify.

The personal tax returns must be reviewed to determine if there is a "meaningful" business loss that may have an impact on the stable monthly income being used to qualify.

A 2-year self-employment history, which includes verifying the borrower has ownership in the business, is required to ensure that the income is stable.

Reminder: The cash flow and an analysis of the trends experienced by the business should be used to determine its viability. Projected gross or net business income, retained earnings, or capital withdrawal generally may not be used when calculating qualifying income.

Confirmation that the borrower’s business remains open and in existence must be verified within 30 calendar days prior to the loan closing. Verification should include:

- Documentation from a third party, such as a CPA, regulatory agency, or licensing bureau.
- Obtaining a phone listing and address for the borrower’s business using telephone book, the Internet or directory assistance.

The lender must document the source of the information obtained as follows:

- Name and address of the business
- The entity contacted (if applicable)
- The date the information is verified
- The name and tile of the person who obtained the verification.

Reminder: A Self-Employed Income Analysis Form, such as Freddie Mac Form 91 or Fannie Mae Form 1084 must be completed on every transaction.

The following schedules and forms are often included in the review of the borrower’s business:

<u>Sole Proprietorship</u>	<u>Partnership</u>	<u>Corporation</u>	<u>S Corporation</u>
Signed 1040	Signed 1040	Signed 1040	Signed 1040
Schedule A	Schedule A	Schedule A	Schedule A
Schedule B	Schedule B	Schedule B	Schedule B
Schedule C	Schedule C (If	Schedule C (If	Schedule C (If
Form 4562	commission income)	commission income)	commission income)
Schedule D (if	Form 4562	Form 4562	Form 4562
Capital Gains)	Schedule D (if	Schedule D (if	Schedule D (if
Schedule E (if	Capital Gains)	Capital Gains)	Capital Gains)
Rental Income)	Schedule E	Schedule E (if	Schedule
Schedule F (if Farm)	Schedule F (if Farm)	Rental Income)	Schedule F (if Farm)
	Form 1065	Schedule F (if Farm)	Form 1120S
	Schedule K1	Form 1120	Schedule K1
	Form 8582 (passive	Form 8582 (passive	Form 8582 (passive
	losses)	losses)	losses)