



Foundations On-Demand

K1 Income Answer Key

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Why are K1s Required?

Q: Why do we need K1s from the borrower?

A: The reason the K1's and business tax returns need to be analyzed is simple: the business pays the borrower's income which pays the mortgage. The stability of the business income directly equates with the borrower's ability to pay the mortgage debt.

Q: What two guidelines must the business income meet in order to use it to qualify a borrower?

A: 1. The borrower can document ownership share in the business (for example, the K-1).
2. The business has adequate liquidity to support the withdrawal of earnings.

Q: Where can you find these guidelines listed?

A: You'll see the guidelines listed at the top of Page 2 of Fannie Mae's Cash Flow Analysis worksheet, Form 1084.

Q: What must you validate in order to use "Ordinary Income" from K1 Line 1?

A: In order to use Ordinary Income from Line 1 of either the K1 for Partnerships or S Corporations, you must validate either Distributions or Liquidity.

Partnership 1065

Q: What are some reasons why "Final" might be checked at the top of the K1?

A: Maybe borrower was bought out by business partners. The partnership may have dissolved and is now a newly named business. Maybe that the business closed completely.

Q: Can you use K1 income if "Final" is checked?

A: No. This income is not stable and recurring.

Q: "Amended" is checked, what is needed to in order to use this income?

A: You will need to find out why and what changed before using the K1 income.

Q: What is need if an individual owns 25% or more in a partnership?

A: You need to request and review two years of their partnership tax-returns for qualifying income.

Q: What is needed if less than 25% of business is owned?

A: Typically you are not required to request the Partnership tax returns.

Q: Where can you find the percentage of ownership your applicant has in the partnership?

A: Line J – This is the partner's share of capital.

S Corporation K1

Q: What should you do if “Final” is checked at the top of the K1?

A: You cannot use this income.

Q: What should you do if “Amended” is checked?

A: Amended means there was a change made to the original K-1. You will need to find out why and what changed.

Q: What should you do if the S Corp K-1 contains Distributions on Line 16 Items affecting shareholder basis, with Code D?

A: Compare the amount to the income being used from Line 1 of the K-1.

Q: When do you need to see to in order to use the information from Line 16?

A: You need to match Line 1 and line 16 and check that there is a history of receiving distributions at the level of ordinary income on Line 1. Then no calculation of liquidity is required.

Q: What do Distributions affect?

A: Distributions do not affect qualifying income, only how the qualifying income is validated.

Q: Will you use the other lines on the K1 as sources of income or loss when calculating business income on the 1084 Cash Flow Analysis worksheet?

A: No.