



Foundations on Demand

Understanding KI Income

Answer Key

Why are K1s Required?

QUESTION

Why do we need K1s from the borrower?

ANSWER

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.

QUESTION

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

ANSWER

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.

QUESTION

Where can you find these guidelines listed?

ANSWER

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

QUESTION

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

ANSWER

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

QUESTION

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

ANSWER

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.

QUESTION

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

ANSWER

No. This income is not stable and recurring.

QUESTION

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

ANSWER

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

QUESTION

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

ANSWER

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

QUESTION

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

ANSWER

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

QUESTION

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

ANSWER

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

S Corporation K1

QUESTION

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

ANSWER

You cannot use this income.

QUESTION

What should you do if “Amended” is checked?

ANSWER

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

QUESTION

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

ANSWER

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

QUESTION

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

ANSWER

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.

QUESTION

What do Distributions affect?

ANSWER

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

QUESTION

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?

ANSWER

No.