

Understanding Foreign Income

Foreign income is defined as income earned by a borrower who is employed by a foreign corporation or a foreign government and is paid in foreign currency. The GSEs, Fannie Mae and Freddie Mac, both allow the use of foreign income under certain circumstances.

In the personal tax returns provided by a borrower, you may see an IRS Form 2555, which identifies the foreign earned income. Many borrowers file this form as an exclusion to their US federal taxes as they may have been taxed by the country where they are earning the income.

Required Documentation for Foreign Income

When it comes to processing foreign income for a loan, documents required may include:

- » Most recent personal tax returns
- » History of receipt
- » Proof of continuance of foreign income earnings
- » Conversion of the income from the foreign currency to US dollars

These documents must be translated or completed in English so that a loan reviewer can properly evaluate the information provided.

Fannie Mae & Freddie Mac Guidelines

Income from Foreign Source

Income from foreign sources must be reported on the borrower's most recent U.S. individual federal income tax returns. Specifics can vary depending on the GSE:

- » **For a Freddie Mac loan file:** A copy of the borrower's most recent, signed US individual federal income tax return is required.
- » **For a Fannie Mae loan file:** A copy of the borrower's most recent two years, signed US individual federal income is required.

Additionally, proof of continuance and conversion calculation to US dollars are necessary.

Personal & Business Tax Returns

When processing foreign income, it is essential to distinguish between personal and business tax returns.

Personal Tax Return

- » **Form 2555:** This IRS form is used to report foreign earned income. It is often included within new Schedule 1 (for 2018 taxes and onwards). The income reported here may be excluded from US federal taxes if the borrower has been taxed by the country where they are earning the income.
- » **Schedule 1:** This feeds into the new 1040 Line 8 (for 2018 taxes and onwards). It summarizes additional income and adjustments to income, which could include foreign earned income.

Business Tax Return

- » If the borrower is self-employed and operates their business from a foreign country, Fannie Mae guidelines allow for foreign self-employed income to be considered. This income is treated the same as US-based business income. However, all financial documentation, including income statements, balance sheets, and tax returns, must be translated into English. Additionally, income must be converted from the foreign currency to US dollars.

Glossary

- » **GSEs:** Government-Sponsored Enterprises like Fannie Mae and Freddie Mac.
- » **IRS Form 2555:** A tax form used by U.S. taxpayers who earned income from sources outside the United States and wish to claim exclusion from U.S. income tax.
- » **History of Receipt:** The documented record showing the history of income received by the borrower.
- » **Proof of Continuance:** Evidence that suggests the income being considered is likely to continue in the future.
- » **Personal Tax Return:** A form (1040, 1040A, or 1040EZ) filed by an individual to the IRS that determines the amount of income tax owed in a single tax year.
- » **Business Tax Return:** A form (including 1120, 1120S, 1065) filed by a corporation to the IRS that reports income, expenses, and other pertinent tax information.

Additional Resources

Fannie Mae & Freddie Mac Guidelines

For an in-depth understanding, refer to the official guides:

- [Fannie Mae Selling Guide: B3-3.1-09, Other Sources of Income](#)
- [Freddie Mac Seller/Service Guide: 5305.1, Requirements for all other income \(non-employment/non-self-employment\)](#)

Currency Conversion Tools

Use online tools to help with currency conversion:

- [Google Currency Converter](#)
- [Oanda Currency Converter](#)

Remember, exchange rates are prone to fluctuate, which may affect your conversions. Always cross-verify the current rates at the time of calculation.

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