



# Foundations On-Demand

K1 Income Answer Key

Disclaimer: This presentation does not constitute tax advice. If you have any questions about any of the material presented, please seek advice from a tax professional.

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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.