

Presented by

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Schedule C

Borrower Income Calculation

A Complete Guide for Mortgage Professionals

FHA · VA · USDA · Freddie Mac · Fannie Mae

Who Is a Schedule C Borrower?

Sole Proprietor

An individual who owns and operates an unincorporated business. Reports all profit or loss on Schedule C of IRS Form 1040.

Independent Contractor

Workers receiving 1099 income who deduct business expenses. Treated as self-employed and required to file Schedule C.

Gig / Freelance Workers

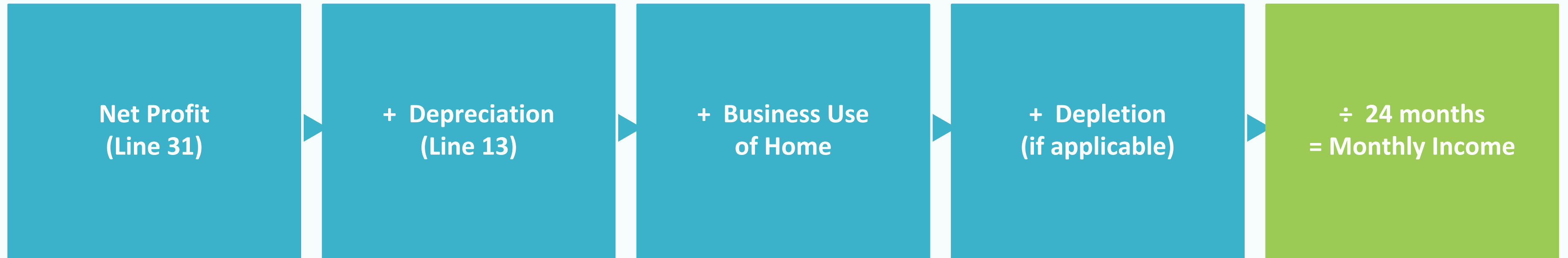
Uber drivers, consultants, freelancers, and similar workers. Even part-time gig income may trigger Schedule C analysis.

Single-Member LLC (SMLLC)

A disregarded entity taxed as a sole proprietor unless S-Corp or C-Corp election is made. Income flows to Schedule C.

Key Rule: 2+ years of self-employment history generally required across ALL agencies

The Core Income Formula



Common Add-Backs & Deductions

ADD BACK	REVIEW	DEDUCTIONS
<ul style="list-style-type: none">• Depreciation (Sch C Line 13)• Amortization / Casualty Loss• Business use of home (Line 30)• Non-recurring losses	<ul style="list-style-type: none">• Mileage deductions (verify vs 2106)• Business meals (partial)• Home office (reconcile with 1098)• One-time large income items	<ul style="list-style-type: none">• Non-recurring income excluded• Net losses reduce other income• Personal expenses misclassified• Large one-time revenue excluded

FHA | Schedule C Income Guidelines

Federal Housing Administration · HUD Handbook 4000.1

Key Requirements

SE History

2 years min. 1-year exception if prior field experience + evidence of same or greater income level documented.

Tax Returns

2 years most recent 1040 with ALL schedules. Business returns required if entity type warrants.

Income Calc

Average of 2-year Schedule C net profit. If Year 2 is lower than Year 1, use Year 2 ONLY (declining income rule).

Depreciation

Must add back depreciation, depletion, and casualty losses from Schedule C Line 13.

P&L Statement

YTD P&L required if >3 months have passed since last tax year. Must be signed by borrower.

Calculation Example

Year 1 Net Profit (Sch C Line 31)	\$48,000
Year 2 Net Profit (Sch C Line 31)	\$52,000
+ Depreciation Add-Back (Line 13)	\$4,200
Adjusted 2-Year Total	\$104,200
÷ 24 months = Monthly Income	\$4,342

FHA Watch-Outs

- Declining income: must use lower year — no averaging
- Business losses count against all qualifying income
- New business < 1 year: generally not eligible
- 4506-C required — IRS transcript must match returns
- Large Schedule C losses can disqualify borrower

VA | Schedule C Income Guidelines

Department of Veterans Affairs · VA Lender's Handbook Chapter 4 (26-7)

Key Requirements

SE History

2 years minimum. VA is strict — shorter history is rarely accepted without compelling, documented evidence.

Tax Returns

2 years federal personal returns with all schedules. Business returns if entity type requires.

Income Calc

2-year average of net profit + depreciation add-backs. Declining income: use lower year only.

Residual Income

VA uniquely requires residual income test IN ADDITION to DTI — borrower must show cash left over by family size and region.

P&L Statement

Required YTD if returns are >120 days old at time of closing. Must support income stability.

VA-Unique Features

Residual Income Test

After PITI + all debts, borrower must have sufficient residual income by family size and geographic region.

No Mortgage Insurance

Lower monthly cost, but income documentation scrutiny is significantly higher.

Effective Income Standard

VA uses 'effective income' — must be likely to continue for at least 3 years into the future.

VA Watch-Outs

- Business losses offset ALL household income
- 1-year SE history almost never approved
- Large depreciation may flag underwriter scrutiny
- Lender overlays are often stricter than VA minimums

USDA | Schedule C Income Guidelines

Rural Development · HB-1-3555 · GUS Underwriting

Key Requirements

SE History

2 years required. Business must be viable and operating within a USDA-eligible rural or suburban area.

Tax Returns

2 years personal returns with all schedules. Business returns required if applicable.

Income Calc

2-year average. USDA calculates BOTH qualifying income (for DTI) and annual household income (for eligibility limits).

Household Income Limits

ALL household members' income counts toward USDA income limits — not just the borrower's qualifying income.

P&L Statement

Required if returns are more than 12 months old. Must confirm business is actively ongoing.

USDA-Unique Features

Dual Income Test

Qualifying income (DTI) and Annual Household Income (eligibility limits) are calculated separately and both matter.

Counts All Household Members

Even non-borrowing adults in the home — roommates, adult children, relatives — may count toward income limits.

Property Must Be Eligible

Business must be in a USDA-eligible area. Income from businesses in ineligible areas adds complexity.

USDA Watch-Outs

- Income limits vary by county — verify BEFORE pre-approving
- Net losses reduce ALL household qualifying income
- GUS AUS may require additional documentation
- Household income test can disqualify even stable earners

Freddie Mac | Schedule C Income Guidelines

Selling Guide Chapters 5306 & 5307 · Freddie Mac Form 91

Key Requirements

SE History

2 years minimum. 1-year exception allowed if borrower was in the same field with W-2 income the prior year.

Tax Returns

2 years personal 1040 with all schedules. If $\geq 25\%$ business ownership, also need 2 years business returns.

Income Calc

Use Freddie Form 91 or proprietary income analysis worksheet. 24-month average unless income is declining.

Declining Income

If Year 2 net profit is lower than Year 1, use Year 2 ONLY — cannot average. Strict application.

Asset Depletion

Freddie allows asset depletion as an alternative qualifying income method for some borrower profiles.

Freddie-Unique Features

LPA (Loan Product Advisor)

Freddie's AUS may allow documentation flexibility when overall risk profile is low.

Multiple Sch C Businesses

Borrower with multiple sole proprietorships: each Schedule C analyzed separately, then netted.

Business Liquidity Test

Significant business assets may be factored into the overall assessment of business stability.

Form 91 Standardization

All conventional Freddie loans require Form 91 — never manually calculate without completing it.

Freddie Watch-Outs

- Business returns required if $\geq 25\%$ ownership
- Declining income: Year 2 only — no averaging permitted
- Mileage on Sch C may need 2106 reconciliation
- LPA feedback can override manual guidelines

Fannie Mae | Schedule C Income Guidelines

Selling Guide B3-3.2-01 · Fannie Mae Form 1084 (Cash Flow Analysis)

Key Requirements

SE History

2 years minimum. 12-month exception possible with strong compensating factors and documented same line of work.

Tax Returns

2 years personal 1040 with all schedules. Business returns required if $\geq 25\%$ ownership in any business entity.

Income Calc

Use FNMA Form 1084. Add back depreciation, amortization, depletion, and business use of home.

Declining Income

If YOY decline $\geq 20\%$ or significant drop is present, use lower year or further reduce per underwriter analysis.

Business Stability

Underwriter must confirm business has adequate liquidity to support ongoing operations and owner draws.

Fannie-Unique Features

DU (Desktop Underwriter)

DU findings may approve borrowers with non-standard documentation when compensating factors are strong.

Form 1084 Required

Standardized worksheet required for all SE borrowers on conventional loans — lenders consistently require it.

Business Liquidity Review

Fannie expects the underwriter to evaluate whether the business can stay viable without over-drawing for personal use.

Part-Year SE Extrapolation

If borrower became SE mid-year, Fannie has specific guidance for annualizing partial-year income.

Fannie Watch-Outs

- 20%+ YOY income decline triggers deeper analysis
- Business returns required if $\geq 25\%$ ownership
- Form 1084 must reconcile line-by-line with Schedule C
- DU findings may supersede manual income calculations

Agency Comparison | At a Glance

Criteria	FHA	VA	USDA	Freddie Mac	Fannie Mae
SE Minimum History	2 yrs (1 yr exception)	2 yrs (strict)	2 yrs	2 yrs (1 yr exception)	2 yrs (1 yr exception)
Declining Income Rule	Use lower year	Use lower year	Use lower year	Use Year 2 only	Use lower or reduce
Business Returns Req'd	If applicable	If applicable	If applicable	≥25% ownership	≥25% ownership
P&L Statement Trigger	YTD if > 3 months	YTD if >120 days	YTD if > 12 months	YTD per guidelines	YTD per guidelines
Calculation Form	HUD 4000.1 / manual	VA 26-7 / manual	HB-1-3555 / GUS	Freddie Form 91	Fannie Form 1084
AUS System	TOTAL Scorecard	VA AUS	GUS	LPA	Desktop Underwriter
Unique Feature	Strict 4506-C match	Residual income	Household income test	Asset depletion OK	DU may override manual

Common Mistakes & Best Practices

Common Mistakes

Averaging when declining

If Year 2 net profit is lower than Year 1, most agencies require using the lower year — not averaging.

Skipping depreciation add-back

Schedule C Line 13 must be added back. It often materially increases qualifying income.

Missing business returns

For Fannie/Freddie with $\geq 25\%$ ownership, business returns are required — don't discover this at underwriting.

Using gross receipts as income

Income is net profit (Line 31), not gross revenue. Using gross receipts is a fundamental error.

Ignoring a business loss

A Schedule C loss must be subtracted from all qualifying income. Leaving it out distorts DTI.

Best Practices

Use the correct agency form

Form 1084 for Fannie, Form 91 for Freddie. For FHA/VA/USDA, follow agency-specific worksheets.

Run YOY trend analysis first

Compare Year 1 vs Year 2 before calculating. Note any decline $\geq 20\%$ and flag for underwriter.

Collect all docs at pre-approval

Get 2 years 1040 + all schedules, YTD P&L, business license, and CPA letter upfront.

Document business stability

Use a CPA letter, business license renewal, or recent bank statements to show business is ongoing.

Read your AUS findings carefully

DU and LPA findings may override manual calculations. Always run AUS and note the income message.

Documentation Checklist | Schedule C Borrowers

Tax Documents

- 2 years signed 1040 with ALL schedules
- Schedule C for each year
- Schedule SE (self-employment tax)
- Form 4562 (depreciation schedule)
- Business tax returns (if $\geq 25\%$ ownership)
- 4506-C — IRS transcript authorization

Financial Documents

- YTD Profit & Loss Statement
- YTD Balance Sheet (recommended)
- 12 months business bank statements
- 12 months personal bank statements
- Documentation of large deposits
- Evidence of business liquidity

Business Verification

- Current business license
- DBA filing (if applicable)
- CPA/accountant letter confirming SE status
- Business website or professional profile
- Evidence of ongoing operations
- Client contracts or engagement letters (opt.)

Key Takeaways

01 2-year SE history is the baseline across ALL agencies — document it thoroughly from the very start.

02 Always compare Year 1 vs Year 2. Declining income changes the calculation method for every agency.

03 Depreciation add-back is required and often materially improves qualifying income — never skip it.

04 Use the right form: Fannie Form 1084, Freddie Form 91, and the correct worksheet for FHA/VA/USDA.

05 Business losses are never ignored — they reduce ALL qualifying income across every agency.

06 VA requires Residual Income analysis. USDA requires a dual income test. Know these unique rules.

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