



Calculating Self-Employment Income for Home Loans

As home loan debt to income ratios tighten, those who are self-employed (and file a Schedule C on their tax returns) may have a challenging time qualifying for a home loan.

Schedule C entrepreneurs have the opportunity to claim (write off) many expenses, which ultimately reduces their tax liability. This is great when it comes to tax time but may not be so great when it comes to qualifying for a home loan, as lenders use the **net income**, not gross, to determine the usable income for lending purposes. Understanding how lenders approach income calculations can help prepare self-employed people who want to purchase a new home or refinance their current home.

Below is an example of a client's Schedule C and how a lender will view and calculate their income.

Calculating Schedule C Income (see attached example **ScheduleC.pdf**):

1. Begin with **Line 31** (Net Profit or Loss): **\$50,070**
2. **Add** back in any expenses from **Line 12** (depletion)/**Line 13** (depreciation): **\$6,000**
3. **Add** back in **Line 30** (Business use of home): **\$2,000**
4. **Subtract** out expenses from Line 24 (Meals and Entertainment): **\$3,000**

\$50,070 + \$8,000 - \$3,000 = \$55,070 ~ total income to be used for qualifying

Total Qualified Income: **\$55,070** divided by **12**

Monthly Income: \$4,589

Maximum 45%* Debt to Income Ratio: \$2,065 (\$4,589 X 45%)

Total Liabilities: Credit Card Payments, Car Payments, Student Loans: \$565

Maximum House Payment Pre-Qualified for: **\$1,500** (\$2,065 - \$565 Liabilities)

\$1,500 House payment must include Principal, Interest, Taxes, Insurance, and HOA if applicable.

*Debt to income ratio maximums varies depending on the overall characteristics of the file.

Keep in mind if the Schedule C shows a loss after the above calculation, the negative income will be counted against the debt to income ratio.

Lenders typically average tax returns over the last two years. If the income has declined year-over-year by more than 10%, it may impact the loan approval.

Please note: this information is general in nature and is not intended as investment, tax or real estate advice. Please refer to your independent tax advisor for further information.

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