Underwriting essentials: Income verification (part 2)

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Commissioned Sales

For employees that earn commission income, confirm the income is one hundred percent commission or base plus commission. Here is what is required for qualification purposes:

Employees (Taxes deducted at source)

- Employment letter and any two of the following documents, from the most recent two tax years, is required to support this income:
  - NOA
  - Year-end paystub
  - T4
- If a portion of the borrower's total income is in the form of commissions, it will be identified in box 42 of the T4 slip. The total income is in box 14
- A two-year average net income is used for qualification purposes. If the annualized income varies from the average by more than 20%, the lower year's income is used for qualification purposes

Self-employed

- Two-year average net income is used for qualification purposes
- Two-year T1 Generals supported by NOAs must be provided
- Line 150 may be grossed up by 15% (if total income includes other income, it must be deducted prior to grossing up, as identified on the T1 General and Statement of Business Activities)
- If the annualized income from the most recent document varies from the average by more than 20%, the lower year's income is used for qualification purposes
- Business for Self tenure must be confirmed for a minimum of two years. This can be confirmed using any of the following:
  - Two years Income Tax Returns supported by NOAs
    - Outstanding taxes > $2,000 must be confirmed paid
  - Two years of GST/HST Returns
  - Two years of Audited Financial Statements
  - Two years of Financial Statements prepared by a licensed accountant
  - A business license showing two years of history
  - Articles of Incorporation showing two years of history

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Contract Employment

Contract employment is defined as non-permanent employment situations. Contract employment is used by companies that are unsure about long-term staffing expectations.

Contract periods vary depending on the specific job function or expected project completion date. Unless specified in the contract, an employer is obligated to deduct all required payroll taxes and deduction.

Here is what is required for qualification purposes:

- The current contract should be for a minimum period of 12 months and should be deemed renewable
- Contract earnings must be supported by a letter of employment or employment contract outlining details of the employment situation and the prospects of the contract being renewed

In addition to a letter of employment or employment contract, any two of the following documents, from the most recent two tax years, is required to support this income:

- NOA - any outstanding taxes > $2,000 must be confirmed paid
- Year-end pay stub
- T4

Two-year average net income is used for qualification purposes. If the annualized income from the most recent document varies from the average by more than 20%, the lower year's income is used for qualification purposes.

Maternity/Paternity Leave

100% of the employment income can be used. Here is what is required:

- A current letter of employment is required confirming the borrower is currently on maternity/parental leave. The letter must include the borrowers return to work date, position and salary

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Support – Spousal/Child

100% of support income can be used where it is demonstrated that such payments have been regularly made and are expected to continue on a regular basis. Here is what is required:

- A copy of the executed Separation Agreement confirming the support payment is required

The Separation Agreement must be supported by ONE of the following:

- The borrower's most recent T1 General supported by the NOA confirming the support income - outstanding taxes > $2,000 must be confirmed paid

OR

- Two-month deposit account history showing regular support payment deposits being made

Disability Income

100% of the employment income can be used. Here is what is required:

Short-term disability insurance

Insurance that covers a percentage of lost salary when there is an illness or injury that takes an individual out of work for a short period of time.

- A letter of employment outlining the borrower(s) return to work date, position, and salary

Long-term/permanent disability insurance

Long-term/permanent disability insurance covers a percentage of lost salary in the case of a catastrophic illness or injury that ends an individual's ability to work or earn an income for an extended period. This insurance comes into effect when short-term disability expires.

- A letter from the appropriate agency or insurance company is required confirming long-term or permanent disability
- Letter from the insurance company must state that the benefit is long-term or permanent, and that the benefit amount is specified
- If the letter is outdated (exceeding 120 days), current bank statements confirming the deposits being made to the borrower's account are required

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Grossing up disability income

If it can be confirmed that the disability income is non-taxable, income can be grossed up using the following guideline:

- Income is less than or equal to $30,000: Income can be grossed up by 25%
- Income is greater than $30,000: Income can be grossed up by 35%

Pension Income

Pension income is defined as a type of retirement plan, usually tax exempt, where an employer makes contributions toward a pool of funds set aside for an employee's future benefit.

Canada Pension Plan (CPP) is a government-administered pension plan to which employers and employees contribute. It is a monthly taxable benefit to retired contributors. Old Age Security (OAS) is a monthly benefit available to most Canadians 65 years of age and older who meet the Canadian legal status and residence requirements.

100% of pension income can be used for qualification purposes.

Here is what is required:

Public pension (i.e. CPP/OAS)

ONE of the following is acceptable:

- T4A for the most recent tax year
- Pension statement from CRA (issued for CPP and OAS for new recipients) that confirms the following:
    - Allowable monthly benefit being paid
    - Borrower's name
    - Borrower's address
- Current bank statement showing two months deposits coinciding with the annual income being used for qualification
- Two most recent NOAs confirming the income used to qualify - outstanding taxes > $2,000 must be confirmed paid
    - NOAs will not specify pension income but will verify income of the borrower
    - NOAs must also be supported by a recent bank statement, showing the last two deposits

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Taxable private pension (i.e. employer pension)

Income must be supported by:

- Two most recent NOAs - outstanding taxes > $2,000 must be confirmed paid

OR

- Two most recent T4As

In addition to the above, ONE of the following documents is also required:

- Current bank statement showing two months deposits coinciding with the annual income being used for qualification
- Current letter from the organization providing the pension income
- Current pension paystub

Non-taxable private pension (i.e. employer pension)

If the private pension income is non-taxable, ONE of the following is acceptable:

- Current letter from the organization providing the pension income outlining that the income is non-taxable
- Current bank statement showing two months deposits coinciding with the annual income being used for qualification
- Two most recent paystubs confirming the income being used to qualify

Grossing up disability income

Pension income may be grossed up if the CRA confirms that it is non-taxable (for example: Guaranteed Income Supplement). Income can be grossed up using the following guideline:

- Income is less than or equal to $30,000: Income can be grossed up by 25%
- Income is greater than $30,000: Income can be grossed up by 35%

Income derived from CPP and OAS cannot be grossed up as both are taxable benefits.