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Proposed regulations: Low-income housing credit, average income test

The U.S. Treasury Department and IRS today released for publication in the Federal Register proposed regulations (REG-119890-18) as guidance on the "average income test" under section 42(g)(1)(C) for purposes of the low-income housing credit.

Read the **proposed regulations** [PDF 284 KB]

The proposed regulations were published in the Federal Register on October 30, 2020, and comments are due by December 29, 2020.

Summary

Before the Consolidated Appropriations Act of 2018 (Pub. L. No. 115-141), section 42(g) set forth two minimum set-aside tests that a taxpayer may elect with respect to a low-income housing project. These are known as the 20-50 test and the 40-60 test.

- Under the 20-50 test, at least 20% of the residential units in the project must be both rent-restricted and occupied by tenants whose gross income is 50% or less of the area median gross income (AMGI).

- Under the 40-60 test, at least 40% of the residential units in the project must be both rent-restricted and occupied by tenants whose gross income is 60% or less of AMGI.

The 2018 Act added section 42(g)(1)(C) to provide a third minimum set-aside test that a taxpayer may elect with respect to a low-income housing project—the average income test.

Under the average income test, a project meets the minimum requirements of the average income test if 40% or more (25% or more in the case of a project described in section 142(d)(6)) of the residential units in the project are both rent-restricted and occupied by tenants whose income does not exceed the imputed income limitation designated by the taxpayer with respect to that unit.

The taxpayer must designate the imputed income limitation for each unit and the designated imputed income limitation of any unit must be 20%, 30%, 40%, 50%, 60%, 70% or 80% of AMGI. The average of the imputed income limitations designated by the taxpayer for each unit must not exceed 60% of AMGI.

The proposed regulations update existing regulations under the "next available unit" provisions of Reg section 1.42-15 to reflect the average income set-aside rules and provide that a taxpayer that has elected the average income set-aside need not comply with the next available unit rule in a specific order. Instead, renting any available comparable or smaller vacant unit to a qualified tenant maintains the status of all over-income units as low-income units until the next comparable or smaller unit becomes available (or, in the case of a deep rent-skewed project, the next low-income unit becomes available).

Prop. Reg. section 1.42-19 allows taxpayers to designate the imputed income limitation of units in accordance with state housing agency procedures relating to such designations, provided that the agency procedures are consistent with any IRS requirements and procedures. Such designations must occur as of the close of the first year of the credit period.

Also, the proposed regulations provide certain mitigating actions a taxpayer may take to avoid not meeting the average income set-aside if a unit's failure to be treated as a low-income unit would cause total disqualification of the project as a low-income project. The Treasury and IRS have requested comments on alternative mitigating actions.

Direct comments, including requests for subscriptions, to Washington National Tax. For more information, contact KPMG's Federal Tax Legislative and Regulatory Services Group at + 1 202.533.4366, 1801 K Street NW, Washington, DC 20006-1301.