§1.42-19 Average income test.

(a) Average income set-aside. A project for residential rental property satisfies the average income test in section 42(g)(1)(C) for a taxable year if the project contains a qualified group of units (within the meaning of paragraph (b)(2) of this section) that constitutes 40 percent or more of the residential units in the project. (In the case of a project described in section 142(d)(6), "40 percent" in the preceding sentence is replaced with "25 percent.")

(b) Definition of low-income unit and qualified group of units--(1) Definition of low-income unit. For purposes of this section, a residential unit is a low-income unit if and only if –

(i) Such unit is rent-restricted (as defined in section 42(g)(2));

(ii) The individuals occupying such unit satisfy the imputed income limitation of that unit designated by the taxpayer in accordance with paragraphs (c)(3) and (d) of this section and with §1.42-19T(c) and (d), or the unit meets the requirements under section 42(g)(2)(D);

(iii) No provision in section 42 (including section 42(i)(3)(B)-(E)) or in the regulations under section 42 denies low-income status to that unit; and

(iv) The unit is part of a qualified group of units under paragraph (b)(2) of this section.

(2) Definition of qualified group of units. A group of residential units is a qualified group of units for a taxable year if and only if—

(i) Each unit in the group satisfies the requirements of paragraphs (b)(1)(i) through (iii) of this section; and

(ii) The average of the imputed income limitations of all of the units in the group does not exceed 60 percent of area median gross income (AMGI).

(3) Identification of qualified groups of units--(i) Average income set-aside test. For each taxable year in the extended use period, the taxpayer must identify a qualified group of units that constitute 40 percent or more of the residential units in the project. The requirements in paragraph (b)(3)(iii) of this section apply to these identifications.

(i) Applicable fraction determinations. For each taxable year in the extended use

period, the taxpayer must identify a qualified group of units to be used in determining the applicable fractions for the buildings in the project.

(A) Identification of the units in the qualified group of units used for determining applicable fractions. The residential units that are identified for purposes of this paragraph (b)(3)(ii) include the units that, under paragraph (b)(3)(i) of this section, are included in the qualified group of units identified for purposes of the set-aside qualification of the project. The taxpayer may identify additional units for inclusion in the group of units used in determining the applicable fractions for buildings in the project provided that the resulting group is a qualified group of units within the meaning of paragraph (b)(2) of this section.

(B) Computing applicable fractions of buildings. For a taxable year, the applicable fraction of a building in a project is computed using the units that are in the particular building and that are also in the qualified group of units for the project identified for purposes of this paragraph (b)(3)(ii). The units included in the applicable fraction of a building do not have to be a qualified group of units on their own. *See* Example 4 of paragraph (e) of this section.

(ii) Identification of units. The recordkeeping and reporting requirements in §1.42-19T(c)(1) apply both to the identification of units that is required by paragraph (b)(3)(i) of this section and the identification of units that is described in paragraph (b)(3)(ii) of this section.

(c) Procedures. (1) - (2) [Reserved]

(3) Designation of imputed income limitations--(i) Timing of designation. (A) Before a unit is first occupied as a low-income unit, or, except as provided in paragraph (c)(3)(i)(B) of this section, is first occupied under a changed income limit, the taxpayer must designate the unit's imputed income limitation or changed imputed income limitation.

(B) For an occupied unit that is subject to a change in imputed income limitation pursuant to paragraph (d) of this section, the taxpayer must designate the unit's changed imputed income limitation not later than the end of the taxable year in which the change occurs.

(ii) 10-percent increments. Under section 42(g)(1)(C)(ii)(III), a designation is valid only if it is one of the following: 20 percent, 30 percent, 40 percent, 50 percent, 60 percent, 70 percent, or 80 percent of AMGI.

(iii) Continuity. Except as provided in paragraph (d) of this section, the imputed income limitation of a residential unit does not change.

(iv) [Reserved]

(4) [Reserved]

(d) Changing a unit's designated imputed income limitation--(1) Permitted changes. Notwithstanding paragraph (c)(3)(iii) of this section, the taxpayer may change

the imputed income limitation of a unit in the following circumstances subject to the timing of designation requirement in paragraph (c)(3)(i)(B) of this section.

(i) Federally permitted changes. Permission for the change is contained in IRS forms, instructions, or guidance published in the Internal Revenue Bulletin pursuant to §601.601(d)(2)(ii)(b) of this chapter.

(ii) Housing credit agency (Agency)-permitted changes. The Agency with jurisdiction of the project has issued public written guidance that provides conditions for a permitted change and that applies to all average income test projects under the jurisdiction of the Agency.

(iii) Certain laws. The change in designation is required or appropriate to enhance protections contained in the following, as amended—

(A) The Americans with Disabilities Act of 1990 (ADA), Pub. L. 101-336, 104 Stat. 328, 42 U.S.C. 12101, et seq.;

(B) The Fair Housing Amendments Act of 1988, Pub. L. 100-430, 102 Stat.1619, 42 U.S.C. 3601, et. seq.;

(C) The Violence Against Women Act of 1994, Pub. L. 103-322, 108 Stat. 1902, 34 U.S.C. 12291, et. seq.;

(D) The Rehabilitation Act of 1973, Pub. L. 93-112, 87 Stat. 394, 29 U.S.C. 701, et seq.; or

(E) Any other State, Federal, or local law or program that protects tenants and that is identified pursuant to paragraph (d)(1)(i) or (ii) of this section.

(iv) Tenant movement. If a current income-qualified tenant moves to a different unit in the project –

(A) The unit to which the tenant moves has its imputed income designation,

if any, changed to the limitation of the unit from which the tenant is moving; and

(B) The vacated unit takes on the prior limitation, if any, of the tenant's new unit.

(v) Restoring compliance with average income requirements. If one or more units lose low-income status or if there is a change in the imputed income limitation of some unit and if either event would cause a previously qualifying group of units to cease to be described in paragraph (b)(2)(ii) of this section, then the taxpayer may designate an imputed income limitation for a market rate unit or may reduce the existing imputed income limitations of one or more other units in the project in order to restore compliance with the average income requirement. The rule in this paragraph (d)(1)(v) may be applied to market-rate, vacant, or low-income units, but, in the case of occupied units, the current tenants must qualify under the new, lower imputed income limitation.

(2) [Reserved]

(e) Examples. The operation of this section is illustrated by the following examples.

(1) Example 1—(i) Facts. (A) A single-building housing project received an allocation of housing credit dollar amount. The taxpayer who owns the project elects the average income test, intending for the 10-unit building to have 100 percent low-income occupancy. The taxpayer properly and timely designates the imputed income limitations for the 10 units as follows: 5 units at 80 percent of AMGI; and 5 units at 40 percent of AMGI. Also, for the first credit year, the taxpayer follows proper procedure in identifying 4 units as the qualified group of units that are to be used for qualifying under the average income set-aside (Units ## 1, 2, 6, and 7). Additionally, for the first credit year, the taxpayer follows proper procedure in identifying all 10 units as the qualified group of units that are to be used for the applicable fraction determination. All of the units in the project are described in paragraphs (b)(1)(i) through (iii) of this section.

Table 1 to Paragraph (e)(1)(i)(A)

Unit Number	Imputed Income Limitation of the Unit
1	80 percent of AMGI
2	80 percent of AMGI
3	80 percent of AMGI
4	80 percent of AMGI
5	80 percent of AMGI
6	40 percent of AMGI
7	40 percent of AMGI
8	40 percent of AMGI
9	40 percent of AMGI
10	40 percent of AMGI

(B) In the first taxable year of the credit period (Year 1), the project is fully leased and occupied.

(ii) Analysis. The identified groups are qualified groups under paragraph (b)(2) of this section. All units in both of the groups are described in paragraphs (b)(1)(i) through
(iii) of this section, and the averages of the imputed income limitations of both the 4-unit group (Units ## 1, 2, 6, and 7) and the 10-unit group do not exceed 60 percent of AMGI.

(A) Average income set-aside. The project qualifies under the average income set-aside because the identified group of 4 units (Units ## 1, 2, 6, and 7) is a qualified group of units that comprise at least 40% of the residential units in the project.

(B) Qualified basis. All 10 units in the identified qualified group of units are used in the applicable fraction determination when calculating qualified basis for purposes of determining the annual credit amount under section 42(a).

(2) Example 2—(i) Facts. Assume the same facts as Example 1 of paragraph (e)(1) of this section. In Year 2, Unit # 6 (which has a designated imputed income limitation of 40 percent of AMGI) becomes uninhabitable. Repair work on Unit # 6 is completed in Year 3. For Year 2, Taxpayer identifies the following as a qualified group of units that are to be used for both the set-aside requirement and the applicable fraction determination: Units ## 1–4 and 7–10. For Year 3, Taxpayer identifies all 10 units as the qualified group of units that are to be used for the set-aside requirement and the applicable fraction determination.

(ii) Analysis. For Year 2, the identified group is a qualified group under paragraph (b)(2) of this section. All 8 units in the group are described in paragraphs

(b)(1)(i) through (iii) of this section, and the average of the imputed income limitations of the 8 units in the group of units does not exceed 60 percent of AMGI.

(A) Average income set-aside. For Year 2, the project qualifies for the average income set-aside because the project contains a qualified group of units that comprises at least 40% of the residential units in the project.

(B) Qualified basis. To determine qualified basis in Year 2, the 8 units in the identified qualified group of units are used in the applicable fraction determination when calculating qualified basis for purposes of determining the annual credit amount under section 42(a). Unit # 6 could not have been identified in the qualified group of units for use in the applicable fraction determination because its lack of habitability prevents it from being a low-income unit. Further, Taxpayer could not have identified all 9 of the habitable units to be used in the qualified group of units for the applicable fraction determination because the average of imputed income limitations of those 9 exceeds 60 percent of AMGI. Taxpayer had a choice of which of Units ## 1–5 it was going to not identify for use in the applicable fraction determination. Omitting any one of them reduces the average limitation of the remaining group of 8 units to an amount that does not exceed 60 percent of AMGI. Given taxpayer's decision to leave out Unit #5, Units ## 1, 2, 3, 4, 7, 8, 9, and 10 are taken into account in the applicable fraction.

(C) Recapture. At the close of Year 2, Unit # 6's unsuitability for occupancy precludes it from being described in paragraph (b)(1)(iii) of this section. Unit # 6's resulting failure to be a low-income unit prevents it from being in a qualified group for purposes of computing the applicable fraction. The decline in the applicable fraction yields a decline in qualified basis, which results in credit recapture under section 42(j) for Year 2. Additionally, Unit # 5 is not a low-income unit because the taxpayer did not include it in the qualified group of units identified for determining the building's applicable fraction. The exclusion of Unit # 5 from the qualified group of units further reduces the applicable fraction for Year 2 and so reduces qualified basis for that year as well. Thus, this exclusion increases the credit recapture amount under section 42(j).

(D) Restoration of habitability and of qualified basis. As described in the facts in paragraph (e)(2)(i) of this section, in Year 3, after repair work is complete, the formerly uninhabitable Unit # 6 is again occupied by a qualified tenant at the same imputed income limitation, and the Taxpayer identifies all 10 units as the qualified group of units that are to be used for the set-aside requirement and the applicable fraction determination. The identified group is a qualified group under paragraph (b)(2) of this section. All 10 units in the group are described in paragraphs (b)(1)(i) through (iii) of this section, and the average of the imputed income limitations of the 10 units in the group of units does not exceed 60 percent of AMGI. For Year 3, all 10 units are included in the qualified group of units for purposes of the average income set-aside test and are a qualified group of units for the applicable fraction determination.

(3) Example 3—(i) Facts. Assume the same facts as Example 2 of paragraph (e)(2) of this section, except that the income for the tenant residing in Unit # 5 has declined so that tenant's income does not exceed 60 percent of AMGI. For Year 2, taxpayer timely redesignates Unit # 5 pursuant to the rule in paragraph (d)(1)(v) of this section so that the imputed income limitation is 60 percent of AMGI instead of 80 percent of AMGI. Taxpayer also makes revisions so that Unit # 5 is rent-restricted under the redesignated imputed income limitation. Taxpayer identifies 9 units (Units ## 1–5 and 7–10) as the qualified group of units that are to be used for the set-aside requirement and the applicable fraction determination.

Table 2 to Paragraph (e)(3)(i)

Unit Number	Imputed Income Limitation of the Unit
1	80 percent of AMGI
2	80 percent of AMGI
3	80 percent of AMGI
4	80 percent of AMGI
5	60 percent of AMGI
~~6~~	40 percent of AMGI
7	40 percent of AMGI
8	40 percent of AMGI
9	40 percent of AMGI
10	40 percent of AMGI

(ii) Analysis. For Year 2, the identified group is a qualified group under paragraph (b)(2) of this section. All 9 units in the group are described in paragraphs (b)(1)(i) through (iii) of this section, and the average of the imputed income limitations of the 9 units in the group of units does not exceed 60 percent of AMGI.

(A) Average income set-aside. For Year 2, project contains a qualified group of units that comprises at least 40% of the residential units in the project.

(B) Qualified basis. To determine qualified basis, all 9 units in the identified qualified group of units are used in the applicable fraction determination when calculating qualified basis for purposes of determining the annual credit amount under section 42(a). Unit # 6 could not have been identified in the qualified group of units for use in the applicable fraction determination because its lack of habitability prevents it from being a low-income unit. Thus, Units ## 1, 2, 3, 4, 5, 7, 8, 9, and 10 are taken into account in the applicable fraction determination.

(C) Recapture. At the close of Year 2, the amount of the qualified basis is less than the amount of the qualified basis at the close of Year 1, because Unit # 6's

unsuitability for occupancy prohibits it from being a low-income unit. Unit # 6's failure to be a low-income unit results in a credit recapture amount under section 42(j) for Year 2 related to Unit #6. Because Units ## 1–5 and 7–10 are all included in the qualified group of units for use in the applicable fraction determination, Units ## 1-5 and 7-10 are included in qualified basis for Year 2 when determining the recapture amount.

(4) Example 4—(i) Facts. (A) A multiple-building housing project consisting of two buildings received an allocation of housing credit dollar amount, and the taxpayer who owns the project elects the average income test. The taxpayer intends for the buildings (each containing 5 units) to have 100 percent low-income occupancy. The taxpayer properly and timely designates the imputed income limitations for the 10 units in Buildings 1 and 2 as follows: Building A contains 2 units at 80 percent of AMGI and 3 units at 40 percent of AMGI; and Building B contains 2 units at 40 percent of AMGI and 3 units at 80 percent of AMGI.

Table 3 to Paragraph (e)(4)(i)(A)

Building A, Unit Number	**Imputed Income Limitation of the Unit**
A1	80 percent of AMGI
A2	80 percent of AMGI
A3	40 percent of AMGI
A4	40 percent of AMGI
A5	40 percent of AMGI
Building B, Unit Number	
B1	40 percent of AMGI
B2	40 percent of AMGI
B3	80 percent of AMGI
B4	80 percent of AMGI
B5	80 percent of AMGI

(B) In the first taxable year of the credit period (Year 1), the project is fully leased and occupied. Also, for the first credit year, the taxpayer follows proper procedure in identifying all 10 units as a qualified group of units for the minimum set-aside and the applicable fraction determination.

(ii) Analysis. For Year 1, the identified group is a qualified group under paragraph (b)(2) of this section. All 10 units in the group are described in paragraphs (b)(1)(i) through (iii) of this section, and the average of the imputed income limitations

of the 10 units in the group of units does not exceed 60 percent of AMGI.

(A) Average income test. The multiple-building project meets the average income test as the project contains a qualified group of units that comprises at least 40% of the residential units in the project. The fact that the average of the income limitations of the units in Building B exceeds 60 percent of AMGI does not impact this result.

(B) Qualified basis. To determine qualified basis, all 10 units in the identified qualified group of units across Building A and Building B are used in the applicable fraction determination when calculating qualified basis of each building for purposes of determining the annual credit amount under section 42(a). The fact that the average of the units in Building B exceeds 60 percent of AMGI does not impact the applicable fraction of Building B because the average of the identified group of units across both buildings does not exceed 60 percent of AMGI.

(5) Example 5—(i) Facts. A single-building housing project received an allocation of housing credit dollar amount, and the taxpayer who owns the project elects the average income test. During Year 2 of the credit period, the tenant residing in a unit with a designated imputed income limitation of 40 percent of AMGI moves to a market- rate unit within the same project. The tenant's income continues to be at or below 40 percent of AMGI.

(ii) Analysis. Under the rule in paragraph (d)(1)(iv) of this section, when the current income-qualified tenant moves to a different unit in the project, the unit to which the tenant moves is eligible for the taxpayer to designate as a unit with a designated imputed income limitation of 40 percent of AMGI. If the taxpayer makes those designations, the unit vacated by the tenant takes on the prior limitation, if any, of the tenant's new unit. In this situation, the vacated unit formerly occupied by the tenant is now a market-rate unit.

(6) Example 6—(i) Facts. A single-building housing project received an allocation of housing credit dollar amount, and the taxpayer who owns the project elects
the average income test. During Year 2 of the credit period, the disability status under the ADA of a tenant changes, and therefore under the provisions of the ADA, the tenant now needs to reside in a different unit with different accommodations. The tenant currently resides in a unit with a designated imputed income limitation of 40 percent of AMGI. A unit that would meet the tenant's needs is available on the first-floor of the building, but it was previously a low-income unit with a designated imputed income limitation of 70 percent of AMGI and thus a higher maximum gross rent than the tenant's current unit. The tenant moves to the first-floor unit.

(ii) Analysis. The tenant's move was required under the ADA. Accordingly, the taxpayer is permitted to change the designation of the imputed income limitation of the first-floor unit so that the unit's designation is 40 percent of AMGI. Under

paragraph (d)(1)(iv) of this section, the vacated unit takes on the prior limitation of 70 percent of AMGI of the tenant's new unit.

(f) Applicability dates–(1) In general. Except as provided in paragraph (f)(3) of this section, this section applies to taxable years beginning after December 31, 2022.

(2) Designations of occupied units. (i) If a residential unit is occupied at the end of the most recent taxable year ending before the first taxable year to which this section applies and if the unit is to be taken into account as a low-income unit under this section as of the beginning of the first taxable year to which this section applies, then not later than the first day of such first taxable year, the taxpayer must designate an imputed income limitation for the unit. The first taxable year to which this section applies means the first taxable year beginning after December 31, 2022, if paragraph (f)(1) of this section applies, or the taxable year described in paragraph (f)(3) of this section if the taxpayer chooses to apply paragraph (f)(3) of this section.

(ii) The designation required by paragraph (f)(2)(i) of this section must comply with paragraph (c)(3)(ii) of this section and §1.42-19T(c)(3)(iv), without taking into account §1.42-19T(c)(4). Section 1.42-19T(c)(2) applies to these designations, except that the Agency may allow the notification to be made along with any other notifications for the first taxable year beginning after December 31, 2022.

(iii) The designated imputed income limitation for the unit may not be less than the income that the current occupant of the unit had when that occupancy began.

(3) Applicability of this section to taxable years beginning before January 1, 2023. A taxpayer may choose to apply this section to a taxable year beginning after **[INSERT DATE OF PUBLICATION IN FEDERAL REGISTER]**, and before January 1, 2023,

provided that the taxpayer chooses to apply §1.42-15 to the same taxable year.

Par. 5. Section 1.42-19T is added to read as follows:

§1.42-19T Average income test (temporary).

(a) - (b) [Reserved]

(c) Procedures—(1) Identification of low-income units for use in the average income set-aside test or the applicable fraction determination--(i) In general. For a taxable year, a taxpayer must follow the procedures described in paragraph (c)(1)(ii) of this section to identify--

(A) A qualified group of units that satisfy the average income set-aside test; and

(B) A qualified group of units used to determine the applicable fraction.

(ii) Recording and communicating. The procedures described in this paragraph (c)(1)(ii) are--

(A) Recording the identification in its books and records, where the identification must be retained for a period not shorter than the record retention requirement under

§1.42-5(b)(2); and

(B) Communicating the annual identifications to the applicable housing credit agency (Agency) as provided in paragraph (c)(2) of this section.

(2) Notifications to the Agency with jurisdiction over a project--(i) Agency flexibility. An Agency may establish the time and manner in which information is annually provided to it.

(ii) Example. An Agency may allow a taxpayer to describe a current year's information by reporting differences from the previous year's information or by reporting that there are no such differences. Various Agencies may choose to apply this manner

of reporting to the identity of a qualified group of units for use in the average income set-aside or applicable fraction determination, or the imputed income limits designated for the various units in a project.

(3) Designation of imputed income limitations. (i) - (iii) [Reserved]

(iv) Recording, retention, and annual communications related to designations. A taxpayer designates a unit's imputed income limitation by recording the limitation in its books and records, where it must be retained for a period not shorter than the record retention requirement under §1.42-5(b)(2). The preceding sentence applies both to units whose first occupancy is as a low-income unit and to previously market-rate units that are converted to low-income status. The designation must also be communicated annually to the applicable Agency as provided in paragraph (c)(2) of this section.

(4) Waiver for failure to comply with procedural requirements. On a case-by-case basis, the Agency has the discretion to waive in writing any failure to comply with the requirements of paragraph (c)(1) or (2) or (c)(3)(iv) of this section up to 180 days after discovery of the failure, whether by taxpayer or Agency. If an Agency exercises this discretion, then the relevant requirements are treated as having been satisfied. In such a case, the tax consequences under this section correspond to that deemed satisfaction.

(d) Changing a unit's designated imputed income limitation. (1) [Reserved]

(2) Process for changing a unit's designated imputed income limitation. The taxpayer effects a change in a unit's imputed income limitation by recording the limitation in its books and records, where it must be retained for a period not shorter than the record retention requirement under §1.42-5(b)(2). The new designation must also be communicated to the applicable Agency as provided in paragraph (c)(2) of this section and must become part of the annual report to the Agency of income designations. The prior designation must be retained in the books and records for the

period specified in paragraph (c)(3)(iv) of this section. A designation under this paragraph (d)(2) is considered to be made in a manner consistent with paragraph (c)(3) of this section.

(e) [Reserved]

(f) Applicability dates–(1) In general. Except as provided in paragraph (f)(3) of this section, this section applies to taxable years beginning after December 31, 2022.

(2) Designations of occupied units. (i) If a residential unit is occupied at the end of the most recent taxable year ending before the first taxable year to which this section applies and if the unit is to be taken into account as a low-income unit under this section as of the beginning of the first taxable year to which this section applies, then not later than the first day of such first taxable year, the taxpayer must designate an imputed income limitation for the unit. The first taxable year to which this section applies means the first taxable year beginning after December 31, 2022, if paragraph (f)(1) of this section applies, or the taxable year described in paragraph (f)(3) of this section if the taxpayer chooses to apply paragraph (f)(3) of this section.

(ii) The designation required by paragraph (f)(2)(i) of this section must comply with §1.42-19(c)(3)(ii) and paragraph (c)(3)(iv) of this section, without taking into account paragraph (c)(4) of this section. Paragraph (c)(2) of this section applies to these designations, except that the Agency may allow the notification to be made along with any other notifications for the first taxable year beginning after December 31, 2022.

(iii) The designated imputed income limitation for the unit may not be less than the income that the current occupant of the unit had when that occupancy

began.

(3) Applicability of this section to taxable years beginning before January 1, 2023.

A taxpayer may choose to apply this section to a taxable year beginning after **[INSERT DATE OF PUBLICATION IN FEDERAL REGISTER]**, and before January 1, 2023, provided that the taxpayer chooses to apply §1.42-15 to the same taxable year.

(4) Expiration date. The applicability of this section expires on October 7, 2025.