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Monitoring Compliance with Income Averaging



**HOME and
Housing Trust
Fund**
JANUARY 13 – 15



Housing Credit
JANUARY 15 – 17



**MRBs and
Other Federal
Homeownership
Programs**
JANUARY 16 – 18



**Section 8 and
Other Federally
Assisted
Multifamily
Housing**
JANUARY 16 – 18



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8609 8b Election

One project

| AVG: 60% | | AVG: 60% | | AVG: 60% | | AVG: 60% | |
|----------|-----|----------|-----|----------|--------|----------|--------|
| 50% | 70% | 50% | 70% | Market | Market | Market | Market |
| 50% | 70% | 50% | 70% | Market | Market | Market | Market |
| 50% | 70% | 50% | 70% | Market | Market | Market | Market |
| 50% | 70% | 50% | 70% | 80% | 40% | 80% | 40% |
| 50% | 70% | 50% | 70% | 50% | 70% | 50% | 70% |

AVG = 60% 

8b Election is not an issue since each building can meet the minimum set-aside. However, other 8b issues (transfers, etc.) should still be considered.

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8609 8b Election

One project

| AVG: 60% | |
|----------|-----|
| 50% | 70% |
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| 50% | 70% |
| 50% | 70% |
| 50% | 70% |

One project

| AVG: 60% | |
|----------|-----|
| 50% | 70% |
| 50% | 70% |
| 50% | 70% |
| 50% | 70% |
| 50% | 70% |

One project

| AVG: 60% | |
|----------|--------|
| Market | Market |
| Market | Market |
| Market | Market |
| 80% | 40% |
| 50% | 70% |

One project

| AVG: 60% | |
|----------|--------|
| Market | Market |
| Market | Market |
| Market | Market |
| 80% | 40% |
| 50% | 70% |

AVG = 60%

8b Election is not an issue since each building can meet the minimum set-aside. However, other 8b issues (transfers, etc.) should still be considered.

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8609 8b Election

One project

AVG: 60%

| | |
|-----|-----|
| 50% | 70% |
| 50% | 70% |
| 50% | 70% |
| 50% | 70% |
| 50% | 70% |

One project

AVG: 60%

| | |
|-----|-----|
| 50% | 70% |
| 50% | 70% |
| 50% | 70% |
| 50% | 70% |
| 50% | 70% |

One project

AVG: 66.7%

| | |
|--------|--------|
| Market | Market |
| Market | Market |
| Market | Market |
| 80% | Market |
| 50% | 70% |

One project

AVG: 56%

| | |
|--------|--------|
| Market | Market |
| Market | Market |
| 40% | Market |
| 80% | 40% |
| 50% | 70% |

AVG = 60%



8b Election IS an issue since each building CANNOT meet the minimum set-aside.

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Designating Units

- Formal or informal?
- Are the designations approved or submitted to anyone (e.g. IRS, state agency)?
- How (and when) does designation occur?
- Can units change designations and, if so, how?
- In mixed income projects, the Available Unit Rule may require market-rate units to become LIHTC

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Minimum Set-Aside vs. Applicable Fraction

- | | | |
|---------------------|---|---|
| Any credits at all? | ① | How many credits? |
| Project | ② | Individual building |
| Unit % only | ③ | Lesser of “unit fraction” and “floor space fraction” |

No change!

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The minimum set-aside has always been a cliff test:

FAIL



[assume one, single-building project at 40-60 set-aside]

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Where is the cliff with income averaging?

DOOMSDAY!



Just because income averaging has a 60% AMI maximum average doesn't mean that one unit being out of compliance would cause a failure of the minimum set-aside and recapture of credits on nine (or 99) others!



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Where is the cliff with income averaging?

AVG: 61.11%

| | |
|---|-----|
|  | 70% |
| 50% | 70% |
| 50% | 70% |
| 50% | 70% |
| 50% | 70% |

The minimum set-aside is satisfied!

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Where is the cliff with income averaging?

AVG: 61.11%

| | |
|---|-----|
|  | 70% |
| 50% | 70% |
| 50% | 70% |
| 50% | 70% |
| 50% | 70% |

Two camps:

Code Literalists

**Minimum Set-Aside
Loyalists**


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Where is the cliff with income averaging?

| | |
|---|-----|
|  | 70% |
| 50% | 70% |
| 50% | 70% |
| 50% | 70% |
| 50% | 70% |

Code Literalists:

(1) a waiver or granted under subsection (d)(2)(B) with respect to the acquisition of the building, and

(2) a credit would be allowed for rehabilitation expenditures with respect to such building if subsection (d)(2)(A)(ii) did not apply and if the dollar amount of such under subsection (d)(2)(A)(iii) were two-thirds of such amount.

(j) Qualified low-income housing project

For purposes of this section—

(1) In general

The term "qualified low-income housing project" means any project the residential rental property of the project meets the requirements of subparagraph (A), (B), or (C) whichever is selected by the taxpayer.

(A) 20-50 test

The project meets the requirements of this subparagraph if 20 percent or more of the residential units in such project are both rent restricted and occupied by individuals whose income is 50 percent or less of area median gross income.

(B) 40-60 test

The project meets the requirements of this subparagraph if 40 percent or more of the residential units in such project are both rent restricted and occupied by individuals whose income is 60 percent or less of area median gross income.

(C) Average income test

(i) In general

The project meets the minimum requirements of this subparagraph if 40 percent or more (20 percent in the case of a project described in section 143(d)(2) of the residential units in such project are both rent restricted and occupied by individuals whose income does not exceed the required average income designated by the taxpayer with respect to the residential unit.

(ii) Special rules relating to income limitation

For purposes of clause (i)—

(I) Designation

The taxpayer shall designate the required average limitation of each unit taken into account under clause (i).

(II) Average test

The average of the required average limitations designated under subclause (I) shall not exceed 60 percent of area median gross income.

(III) 10 percent increments

The designated average income limitation of any unit under subclause (I) shall be 20 percent, 40 percent, 40 percent, 50 percent, 40 percent, 70 percent, or 80 percent of area median gross income.

Any election under this paragraph, once made, shall be irrevocable. For purposes of this paragraph, any property shall not be treated as liable to be residential rental property merely because part of the building in which such property is located is used for purposes other than residential rental purposes.

(2) Rent-restricted units

(A) In general

IRC § 42(g)(1)

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(C) Average income test

(i) In general

The project meets the minimum requirements of this subparagraph if 40 percent or more (25 percent or more in the case of a project described in section 142(d)(6)) of the residential units in such project are both rent-restricted and occupied by individuals whose income does not exceed the imputed income limitation designated by the taxpayer with respect to the respective unit.

(ii) Special rules relating to income limitation

For purposes of clause (i)-

(I) Designation

The taxpayer shall designate the imputed income limitation of each unit taken into account under such clause.

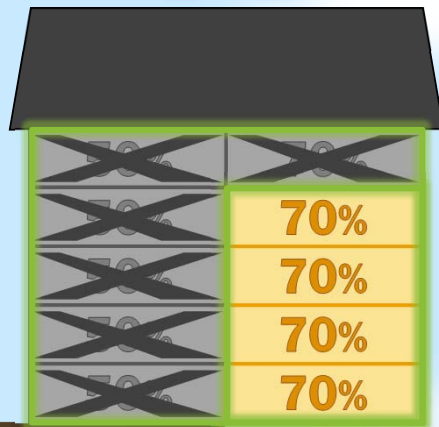
(II) Average test

The average of the imputed income limitations designated under subclause (I) shall not exceed 60 percent of area median gross income.

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Where is the cliff with income averaging?



Code Literalists:

“All units are still *designated* to have income limits averaging 60% or less.”

“At least 40% of units are still meeting *their designation.*”

“The code doesn’t say that being out of compliance makes a unit lose its designation.”

still

“The minimum set-aside is *still* satisfied.”

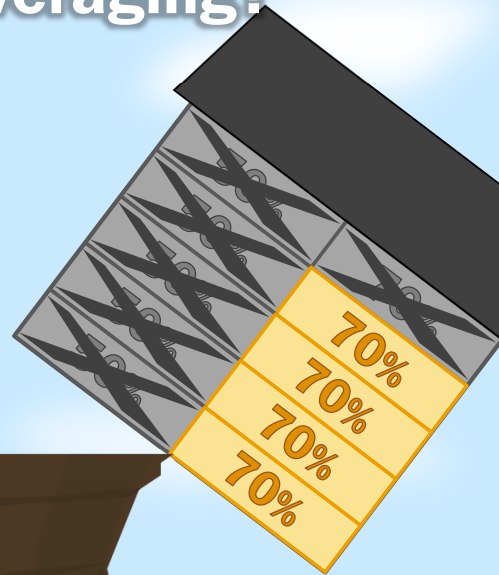
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Where is the cliff with income averaging?



Minimum Set-Aside Loyalists:

“All units are still *designated* to have income limits averaging 60% or less.”

“At least 40% of units are still meeting *their designation.*”

“The code doesn’t say that being out of compliance makes a unit lose its designation.”

still

“The minimum set-aside is satisfied.”

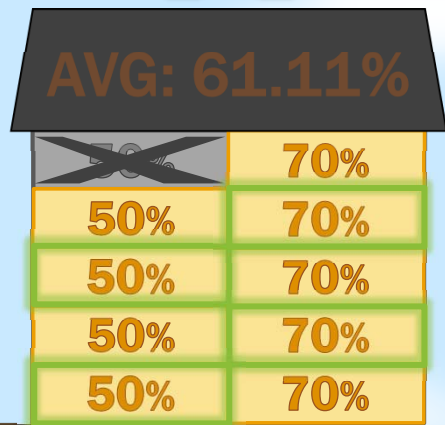
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Where is the cliff with income averaging?



Minimum Set-Aside Loyalists:

“At least 40% of the units are meeting their designation...and the designations of those units used for the minimum set-aside test have income limits averaging 60% or less.”

“The minimum set-aside is satisfied.”

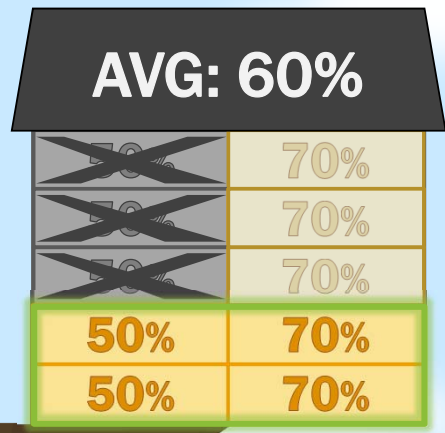
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Applicable Fraction...



Minimum Set-Aside Loyalists:

“Discount unit(s) necessary to bring average of remaining units to ≤60%”

“Claim credits only on units that collectively are meeting the average of ≤60%”

Applicable Fraction

$$\frac{4}{10} = 40\%$$



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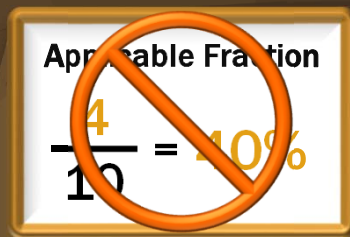
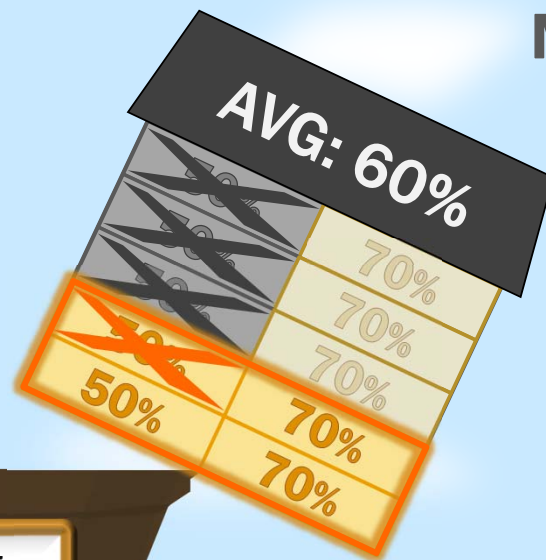
Applicable Fraction...

Minimum Set-Aside Loyalists:

“Discount unit(s) necessary to bring average of remaining units to $\leq 60\%$ ”

“Claim credits only on units that collectively are meeting the average of $\leq 60\%$ ”

FAIL



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Applicable Fraction...

| | |
|----------------|----------------|
| 50% | 70% |
| 50% | 70% |
| 50% | 70% |
| 50% | 70% |
| 50% | 70% |

Code Literalists:

“If the minimum set-aside is satisfied... claim credits on all units meeting their designation.”

Applicable Fraction

$$\frac{9}{10} = 90\%$$

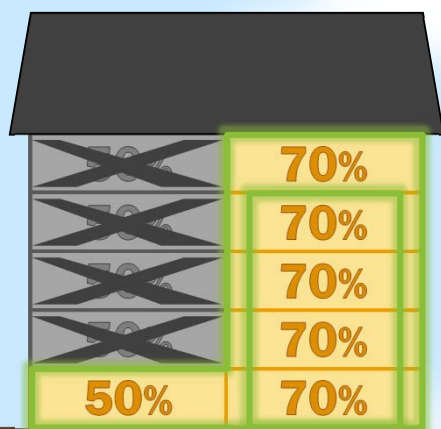
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Applicable Fraction...



Code Literalists:


“If the minimum set-aside is satisfied... claim credits on all units meeting their designation.”

Applicable Fraction

$$\frac{6}{10} = 60\%$$

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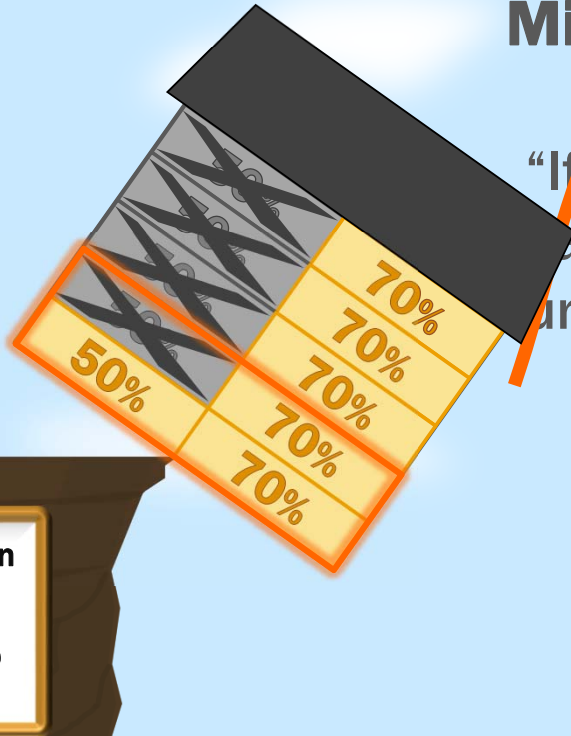
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Applicable Fraction...

Minimum Set-Aside Loyalists:


“If the minimum set-aside is satisfied... claim credits on all units meeting their designation.”

FAIL



| |
|-----|
| 70% |
| 70% |
| 70% |
| 70% |
| 70% |
| 50% |

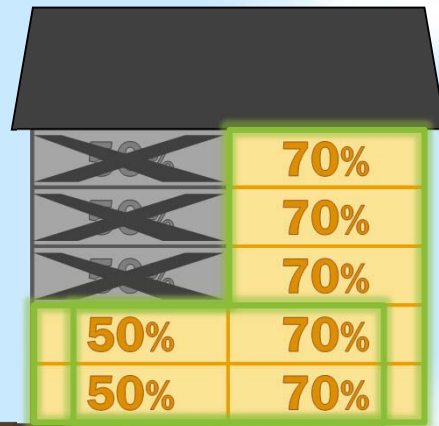
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Third camp...



Applicable Fraction

$$\frac{7}{10} = 70\%$$

Hybrid:

Minimum Set-Aside Loyalists for the minimum set-aside test for the project

Code Literalists for meeting the applicable fraction(s) for the building(s)

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