

## Section 42.--Low-Income Housing Credit

(Also Section 7805; 301.7805-1)

Rev. Rul. 2020-4

### ISSUE

For purposes of the low-income housing credit under § 42 of the Internal Revenue Code (Code), how should the income limits in the average income test under § 42(g)(1)(C) be computed?

### LAW

The Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2085 (1986 Act) created the low-income housing credit under § 42 of the Code.

Section 42(a) provides that the amount of the low-income housing credit for any taxable year in the credit period is an amount equal to the applicable percentage of the qualified basis of each qualified low-income building.

Section 42(c)(1)(A) provides that the qualified basis of any qualified low-income building for any taxable year is an amount equal to (i) the applicable fraction (determined as of the close of the taxable year) of (ii) the eligible basis of the building (determined under § 42(d)). Sections 42(c) and 42(d) define applicable fraction and

eligible basis. Section 42(d)(1) and (2) define the eligible basis of a new building and an existing building, respectively.

Generally, section 42(c)(2) defines a qualified low-income building as any building that is part of a qualified low-income housing project at all times during the compliance period (the period of 15 taxable years beginning with the first taxable year of the credit period). To qualify as a low-income housing project, one of the § 42(g) minimum set-aside tests, as elected by the taxpayer, must be satisfied.

Prior to the enactment of the Consolidated Appropriations Act of 2018, Pub. L. No. 115-141, 132 Stat. 348 (2018 Act), § 42(g) set forth two minimum set-aside tests, known as the 20-50 test and the 40-60 test. Under the 20-50 test, at least 20 percent of the residential units in the project must be both rent-restricted and occupied by tenants whose gross income is 50 percent or less of the area median gross income (AMGI). Under the 40-60 test, at least 40 percent of the residential units in the project must be both rent-restricted and occupied by tenants whose gross income is 60 percent or less of AMGI.

Section 103 of Division T of the 2018 Act added a third minimum set-aside test, the average income test, under § 42(g)(1)(C). Section 42(g)(1)(C)(i) provides that, a project meets the minimum requirements of the average income test if 40 percent or more (25 percent or more in the case of a project located in a high cost housing area) 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 the respective unit.

Section 42(g)(1)(C)(ii) provides special rules relating to the income limitation. Specifically, the taxpayer must designate the imputed income limitation for each unit. The designated imputed income limitation of any unit must be 20, 30, 40, 50, 60, 70, or 80 percent of AMGI. The average of the designated imputed income limitations must not exceed 60 percent of AMGI.

Under § 42(g), once a taxpayer elects to use a particular set-aside test, that election is irrevocable. Section 42(g)(4) provides generally that § 142(d)(2) applies for purposes of determining whether any project is a qualified low-income housing project and whether any unit is a low-income unit.

Section 142(d)(2)(B) provides that the income of individuals and AMGI is determined in a manner consistent with determinations of lower income families and AMGI under Section 8 of the United States Housing Act of 1937 (Section 8) or, if the Section 8 program is terminated, under the program as in effect immediately before the termination. Determinations under the preceding sentence include adjustments for family size.<sup>1</sup>

In determining eligibility for various aspects of the Section 8 program, the Department of Housing and Urban Development (HUD) uses three different principal income level calculation categories: (1) low-income; (2) very low-income; and (3) extremely low-income. Specifically, HUD sets the low-income limits at 80 percent of

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<sup>1</sup> For descriptions of HUD's determinations of income limits, see HUD, FY2019 INCOME LIMITS, FREQUENTLY ASKED QUESTIONS (2019), [https://www.huduser.gov/portal/datasets/il/il19/FAQs\\_19.pdf](https://www.huduser.gov/portal/datasets/il/il19/FAQs_19.pdf), and HUD, ASSESSMENT OF SMALL AREA MEDIAN FAMILY INCOME ESTIMATES (2018), <https://www.huduser.gov/portal/sites/default/files/pdf/Assessment-of-Small-Area-Median-Family-Income-Estimates.pdf>.

AMGI, the very low-income limits at 50 percent of AMGI, and the extremely low-income limits at the higher of 30 percent of AMGI or the “Federal Poverty Level.” See HUD, FY2019 INCOME LIMITS, METHODOLOGY FOR DETERMINING SECTION 8 LIMITS at 1 (2019) (hereinafter, HUD METHODOLOGY).<sup>2</sup>

In describing the unique role of the very low-income limits, HUD explains, “The very low-income limits (usually based on 50 percent of median incomes) are the basis of all other income limits, as they are the best-defined income limits and have been the subject of specific, limited legislative adjustments subsequent to reviews of the HUD calculation methodology.” HUD METHODOLOGY at 2. Several of the HUD income limit standards are intended to have progressive relationships with respect to other limits and, to ensure this, unless there is explicit statutory language to the contrary, HUD uses the very low-income limits as the basis for deriving these limits. *Id.*

The conference committee report for the 1986 Act states that HUD’s AMGI as adjusted by family size serves as the base for computing the income limits of § 42(g). See H.R. Rep. No. 99-841, 1986-3 C.B. Vol. 2. The report provides further, in part, that, for purposes of the then-existing set-aside tests (the 20-50 and 40-60 tests), for areas with unusually low family income or high housing costs relative to family income, adjustments should be made in a manner consistent with determinations of very low-income families and AMGI under Section 8. *Id.*

Rev. Rul. 89-24, 1989-1 C.B. 24 (as modified and superseded in part by Rev. Rul. 94-57, 1994-2 C.B. 5 for the limited purpose of permitting taxpayers to rely on a list

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<sup>2</sup> <https://www.huduser.gov/portal/datasets/il/il19/IncomeLimitsMethodology-FY19.pdf>.

of income limits released by HUD), provides the manner in which to properly compute the income limits applicable under § 42 with respect to the 20-50 and 40-60 tests. The income limits are computed based on the income limits of the very low-income families under Section 8, as adjusted by family size. This is consistent with the legislative history's reference to HUD's very low-income limits.

#### ANALYSIS AND HOLDING

Consistent with the holding in Rev. Rul. 89-24, the Internal Revenue Service (Service) has required that HUD's determinations for very low-income families be used in calculating the low-income housing credit income limits of 50 percent and 60 percent of AMGI. In adding the average income test, Congress did not indicate that a different HUD income level calculation category should be used, and therefore, this revenue ruling continues to use HUD's determinations for very-low income families.

Moreover, for purposes of Section 8, HUD makes numerous, additional adjustments to arrive at the low-income (80 percent) and extremely low-income (30 percent) determinations. See HUD METHODOLOGY at 2. Those adjustments may be irrelevant to the overall structure of the low-income housing credit. Additionally, when HUD seeks for its income limit determinations to have a progressive relationship with respect to other limit determinations, HUD bases its income limit calculations on the very low-income limits. Similarly, because § 42(g)(1)(C)(ii)(II) requires computing an average of the income limits, the relationship of all of the limits under the average income set aside should be preserved and uniformly incremental. Therefore, these

income limits should be determined by computing them all from the same basis, that is, from HUD's very low-income limits.

For these reasons, this revenue ruling holds that HUD's very low-income calculation, as adjusted by family size and consistent with the methods provided in Rev. Rul. 89-24, is to be used as the basis for determining the full range of income limits under the average-income set-aside. As described in Rev. Rul. 89-24, the income limits for the very low-income families for purposes of Section 8 are computed and listed according to family size by HUD. HUD computes and lists these limits for metropolitan areas (some Core Based Statistical Areas (CBSAs) as defined by the Office of Management and Budget (OMB) and some HUD-defined components of OMB-defined CBSAs)<sup>3</sup> and for nonmetropolitan counties of the United States and Puerto Rico. HUD also computes and releases income limits for Guam, the Virgin Islands, American Samoa, and the Northern Mariana Islands.

For the average income test under § 42(g)(1)(C), the 20, 30, 40, 50, 60, 70, and 80 percent of AMGI income limitations must be calculated as follows—

Twenty (20) percent limit: 40 percent or less of the income limit for a very low-income family of the same size.

Thirty (30) percent limit: 60 percent or less of the income limit for a very low-income family of the same size.

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<sup>3</sup> HUD identifies Core Based Statistical Areas (CBSAs) with the "Metropolitan Statistical Area (MSA)" designation, and HUD-defined metropolitan areas as "HUD Metropolitan Fair Market Rent Areas (HMFA)." The set of CBSAs and HMFAs together identify the complete list of OMB-defined metropolitan areas.

Forty (40) percent: 80 percent or less of the income limit for a very low-income family of the same size.

Fifty (50) percent: equal to or less than the income limit for a very low-income family of the same-size.

Sixty (60) percent: 120 percent or less of the income limit for a very low-income family of the same size.

Seventy (70) percent limit: 140 percent or less of the income limit for a very low-income family of the same size.

Eighty (80) percent limit: 160 percent or less of the income limit for a very low-income family of the same size.

As provided by Rev. Rul. 94-57, 1994-2 C.B. 5, a list of income limits released by HUD may be relied upon until 45 days after HUD releases a new list of income limits, or until HUD's effective date for this new list, whichever is later.

#### EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 89-24, as modified and superseded by Rev. Rul. 94-57 in part, is amplified.

#### PROSPECTIVE APPLICATION

Pursuant to § 7805(b)(8), the application of this revenue ruling is modified to the extent provided below:

(1) If—

(A) The taxpayer submitted a document to a State or local housing credit agency (Agency) as part of, or in connection with, the taxpayer's request for an allocation of a housing credit dollar amount for a project,

(B) The request unambiguously indicated that the taxpayer intended to elect the average-income set-aside, the request unambiguously indicated that a specific dollar amount was an expected designated imputed income limitation for a unit in the project, and that dollar amount is higher than the amount determined under this revenue ruling,

(C) The taxpayer's treatment of that amount in this manner was reasonable, and

(D) Prior to **[INSERT DATE OF PUBLICATION IN THE IRB]**, the Agency allocated a housing credit amount in response to that request,

then, consistent with the second sentence of § 42(g)(2)(A), for that taxpayer, for the remaining compliance period of the building that contains the relevant unit, the dollar amount for the income limits under this revenue ruling for that unit is not less than that reasonable amount.

(2) If—

(A) Paragraph (1) of this prospective application section of this revenue ruling applies to a project,

(B) When a tenant began occupancy of a unit in the project, the tenant's income exceeded the amount that would otherwise be required by this revenue ruling, but

(C) The tenant's income at that time did not exceed the amount that paragraph (1) permits to be used for that unit,

then, for purposes of § 42(g)(2)(D), the tenant is treated as having initially met the income limitation for the unit.

Except as expressly provided in this prospective application section of this revenue ruling, both a low-income housing project that has elected the average income test and tenants in such a project must meet all other rules and requirements of § 42.

#### DRAFTING INFORMATION

The principal author of this revenue ruling is Dillon Taylor of the Office of Associate Chief Counsel (Passthroughs & Special Industries). For further information regarding this revenue ruling, contact Mr. Taylor at (202) 317-4137 (not a toll-free call).