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New Income Averaging Guidance (Revenue Ruling 2020-4)

On January 30, 2020 the IRS recently issued Revenue Ruling 2020-4 that provides additional guidance on calculating income limit designations for units in a project that has selected the Average Income Test to qualify for the Minimum Set-Aside threshold. Below is an overview of the income averaging test and the new guidance. Here is a link to the full text of Revenue Ruling 2020-4: https://www.buchalter.com/wp-content/uploads/2020/02/Rev-Rul-2020-4.pdf

Average Income Test
First, a refresher. To qualify as an LIHTC project, the taxpayer must provide a minimum number of low-income units (satisfying the Minimum Set-Aside test). Previously a project met the Minimum Set-Aside threshold based on either the 20-50 Test (at least 20% of units are rent restricted and occupied by households with income less than 50% of area median gross income or AMGI) or the 40-60 Test (at least 40% of units are rent restricted and occupied by households with income less than 60% of AMGI. The 40-60 Test was by far the most common.

The new test, the Average Inco me Test, enacted as part of the Consolidated Appropriations Act of 2018, requires that 40% of units are rent restricted and occupied by individuals whose income does not exceed the income limitation designated by the taxpayer with respect to that unit. Designations can be 20%, 30%, 40%, 50%, 60%, 70%, or 80% of AMGI. Additionally, the average of designated income limits cannot be greater than 60%. This allows for a wider mix of income limits as lower income limit units offset higher income limit units (e.g. 20% units enable a project to also have 80% units and still average to 60% or less).

Rev. Rul. 2020-4
Revenue Ruling 2020-4 addresses an oversight that Congress did not clarify how to set the 20% - 80% limits for each unit. The IRS has provided that the income limits should be calculated using HUD's "very-low income" (VLI) calculation, adjusted for family size. There for each limit will be calculated as follows:

20% = 40% or less of the VLI adjusted for family size
30% = 60% or less of the VLI adjusted for family size
40% = 80% or less of the VLI adjusted for family size
50% = equal to or less than the VLI adjusted for family size
60% = 120% or less of the VLI adjusted for family size
70% = 140% or less of the VLI adjusted for family size
80% = 160% or less of the VLI adjusted for family size

Prospective Application

While LIHTC practitioners had been assuming that income limits would be based on VLI calculation, the Revenue Ruling does apply prospectively only. Therefore, if a taxpayer submitted an application using calculations that resulted in income limits higher than under the VLI calculation, the calculations were reasonable (e.g. based on other HUD income calculations), and were allocated credits based on that, the dollar amounts for the income limits will not be less than those selected by the taxpayer. In effect, the taxpayer will be able to use the approved, reasonable limits until the VLI calculations under the revenue ruling exceed those implemented by the taxpayer.

If you have any questions please contact Patrick Kennedy III or any other member of our Community Finance Development Industry Group.

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