Internal Revenue Service Revenue Ruling 94-57 (Changes in Area Median Gross Income)

Rev. Rul. 94-57

ISSUES

For the low-income housing credit under section 42 of the Internal Revenue Code:

(1) What is the effect of a change in area median gross income (AMGI) on the income limitation used to determine whether a tenant qualifies as a low-income tenant under section 42(g)(1)?

(2) What is the effect of a change in AMGI on the determination of whether any available residential unit must be rented to a new low-income tenant under section 42(g)(2)(D)(ii)?

FACTS

The Project, a single-building, qualified low-income housing project, received a housing credit dollar amount allocation from a housing credit agency (the Agency) in 1990. The Project was placed in service and began its credit period in 1991. When the Project owner first filed the Project's Form 8609, Low-Income Housing Credit Allocation Certification, the Project owner elected the 40-60 test of section 42(g)(1)(B).

In January 1992, the Tenant took initial occupancy of a rent- restricted residential unit in the Project. At the time the Tenant initially occupied the unit, 60 percent of AMGI, as adjusted for family size, in the area in which the Project is located, as defined in Rev. Rul. 89-24, 1989-1 C.B. 24, was $30x and the Tenant's annual income was $29x. Therefore, the unit that the Tenant occupied qualified as a low-income unit under section 42(i)(3).

On May 5, 1993, AMGI, as determined in a manner consistent with section 8 of the United States Housing Act of 1937 (H.U.D. section 8), decreased so that 60 percent of AMGI, as adjusted for family size, in the area in which the Project is located was $25x.

On March 30, 1994, the Tenant's annual income was recertified under section 1.42-5(b)(1)(vi) of the Income Tax Regulations at $36x.

On April 1, 1994, another residential unit in the Project, which was not a low-income unit, became vacant. That unit is of comparable size to the unit occupied by the Tenant. As of April 1, 1994, 60 percent of AMGI remained $25x, as adjusted for family size. At all times, the unit occupied by the Tenant remained rent-restricted.

LAW

Section 42(g)(1) defines a "qualified low-income housing project" as any project for residential rental use that meets one of the following requirements: (A) 20 percent or more of the residential units in the project are both rent-restricted and occupied by individuals whose income is 50 percent or less of AMGI, as adjusted for family size, or (B) 40 percent or more of the residential units in the project are both rent-restricted and occupied by individuals whose income is 60 percent or less of AMGI, as adjusted for family size. These requirements are referred to as the minimum set-asides. Section 142(d)(1) contains similar requirements for exempt facility bonds the net proceeds of which are to be used to provide qualified residential rental projects.

Section 42(i)(3)(A) defines the term "low-income unit" as any unit in a building if: (i) the unit is rent-restricted (as defined in section 42(g)(2)), and (ii) the individuals occupying the unit meet the income limitation applicable under section 42(g)(1) to the project of which the building is a part (low-income tenants).

Section 42(g)(2)(D)(i) provides that, except as provided in section 42(g)(2)(D)(ii), notwithstanding an increase in the income of the occupant of a low-income unit above the income limitation applicable under section 42(g)(1), the unit continues to be treated as a low- income unit if the income of the occupants initially met the income limitation and the unit continues to be rent-restricted. Section 42(g)(2)(D)(ii) provides, however, that if the income of the occupants of the unit increases above 140 percent of the income limitation applicable under section 42(g)(1), a unit ceases to qualify as a low-income unit if any residential unit in the building (of a size comparable to, or smaller than, the unit) is occupied by a new resident whose income exceeds the income limitation. Section 142(d)(3) contains similar requirements for exempt facility bonds the net proceeds of which are to be used to provide qualified residential rental projects.

Under section 42(g)(4), section 142(d)(2)(B) applies when 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 H.U.D. section 8. Accordingly, the determinations of lower income families and AMGI under H.U.D. section 8 apply to section 42(g)(1) and, therefore, to section 42(g)(2) and section 42(i)(3).

ANALYSIS

Issue 1. For a unit to be a low-income unit, a low-income tenant must meet the applicable income limitation elected by a project owner under section 42(g)(1) at the

time the tenant initially occupies a rent-restricted residential unit in the owner's project. If a tenant initially satisfied the applicable income limitation, the unit remains a low-income unit, except as provided in section-42(g)(2)(D)(ii), notwithstanding an increase in the tenant's income (assuming the unit continues to be rent-restricted). See 2 H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess. II-93 (1986). Similarly, if AMGI decreases in a project's area, a low-income tenant who occupied a residential unit prior to the decrease in AMGI will continue to qualify as a low-income tenant if the tenant qualified as a low- income tenant at the time of the tenant's initial occupancy. Thus, a change in a tenant's income or a change in AMGI occurring subsequent to the tenant's initial occupancy does not cause that tenant to cease to be a low-income tenant as of initial occupancy.

On the other hand, a decrease in AMGI commensurately decreases the income limitation under section 42(g)(1) used to determine whether a tenant initially qualifies as a low-income tenant if the tenant's initial occupancy occurs on or after the effective date of the decrease in AMGI. Likewise, an increase in AMGI commensurately increases the income limitation under section 42(g)(1) used to determine whether a tenant initially qualifies as a low-income tenant if the tenant's initial occupancy occurs on or after the effective date of the increase in AMGI. Therefore, a tenant that initially occupies a residential unit after the effective date of a change in AMGI (whether AMGI increases or decreases for the area) must qualify based on the AMGI in effect at the time the tenant initially occupies the unit.

Under the facts presented, as of its initial occupancy, the Tenant is a low-income tenant because the Tenant's annual income at the time the Tenant initially occupied a residential unit in the Project, $29x, was less than the income limitation applicable to the Project, $30x, as adjusted for family size. The result would be the same under section 142(d)(1).

Issue 2. Notwithstanding the analysis of Issue 1, if the income of the occupants in a low-income unit increases above 140 percent of the income limitation under section 42(g)(1), that unit ceases to qualify as a low-income unit unless the project owner rents any available residential unit of comparable or smaller size to a new low-income tenant. A decrease in AMGI decreases the income limitation under section 42(g)(1). Accordingly, a decrease in AMGI decreases the income limitation used to calculate whether a project owner must rent any available residential unit of comparable or smaller size to a new low-income tenant under section 42(g)(2)(D)(ii). Likewise, an increase in AMGI increases the income limitation under section 42(g)(2)(D)(ii) used to calculate whether a project owner must rent any available residential unit of comparable or smaller size to a new low-income tenant.

On April 1, 1994, 140 percent of the applicable income limitation for the Project was $35x (1.4 times $25x), as adjusted for family size. Because the Tenant's annual income is $36x, for the Tenant's unit to continue to qualify as a low-income unit, the Project owner must rent the residential unit that became vacant on April 1, 1994, to a tenant whose income does not exceed the applicable income limitation of $25x, as adjusted for family size. The result would be the same under section 142(d)(3).

HOLDINGS

(1) A decrease in AMGI commensurately decreases the income limitation under section 42(g)(1) used to determine whether a tenant initially qualifies as a low-income tenant if the tenant's initial occupancy occurs on or after the effective date of the decrease in AMGI. Likewise, an increase in AMGI commensurately increases the income limitation under section 42(g)(1) used to determine whether a tenant initially qualifies as a low-income tenant if the tenant's initial occupancy occurs on or after the effective date of the increase in AMGI. This holding would also apply under section 142(d)(1).

(2) A decrease in AMGI decreases the income limitation used to calculate whether a project owner must rent any available residential unit of comparable or smaller size to a new low-income tenant under section 42(g)(2)(D)(ii). Likewise, an increase in AMGI increases the income limitation used to calculate whether a project owner must rent any available residential unit of comparable or smaller size to a new low-income tenant under section 42(g)(2)(D)(ii). This holding would also apply under section 142(d)(3).

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 89-24, 1989-1 C.B. 24, 25, provides that a list of income limits released by the Department of Housing and Urban Development (HUD) may be relied upon until 30 days after the Internal Revenue Service publishes an announcement or notice in the Internal Revenue Bulletin indicating that HUD has released updated income limits. Rev. Rul. 89-24 is modified and superseded. In the future, taxpayers may rely on a list of income limits released by HUD 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. However, under section 7805(b), taxpayers may rely on the income limits in effect prior to May 5, 1993, until 30 days after September 12, 1994.

PROSPECTIVE APPLICATION

The Service will not retroactively apply the holdings in this revenue ruling to the extent the holdings in this revenue ruling adversely affect taxpayers.

DRAFTING INFORMATION

The principal author of this revenue ruling is Jeffrey A. Erickson of the Office of the Assistant Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue ruling, contact Mr. Erickson 622-3040 (not a toll-free call).