INTERNAL REVENUE
BULLETIN

IRS

HIGHLIGHTS OF THIS ISSUE

Bulletin No. 2022–44
October 31, 2022

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

ADMINISTRATIVE

T.D. 9966, page 380.

This guidance contains amendments to the regulations relating to user fees for enrolled agents and enrolled retirement plan agents. In accordance with the guidelines in OMB Circular A-25, the IRS has re-calculated its cost of overseeing the enrollment and renewal program and determined that the full cost for overseeing the renewal of enrolled retirement plan agents has increased from $67 to $140. In addition, the cost for overseeing both the enrollment and renewal of enrolled agents has increased from $67 to $140. Therefore, the regulations increase the renewal user fee for enrolled retirement plan agents from $67 to $140. In addition, the proposed regulations increase both the enrollment and renewal user fee for enrolled agents from $67 to $140.

INCOME TAX

REG-113068-22, page 405.

These proposed regulations provide recordkeeping and reporting requirements for the average income test for purposes of the low-income housing credit. If a building is part of a residential rental project that satisfies this test, the building may be eligible to earn low-income housing credits. These proposed regulations affect owners of low-income housing projects and State or local housing credit agencies that monitor compliance with the requirements for low-income housing credits.

Rev. Rul. 2022-19, page 379.

Fringe benefits aircraft valuation formula. For purposes of section 1.61-21(g) of the Income Tax Regulations, relating to the rule for valuing non-commercial flights on employer-provided aircraft, the Standard Industry Fare Level (SIFL) cents-per-mile rates and terminal charges in effect for the second half of 2022 are set forth.

T.D. 9967, page 385.

These final and temporary regulations set forth guidance on the average income test under section 42(g)(1)(C) of the Internal Revenue Code. If a building is part of a residential rental project that satisfies this test, the building may be eligible to earn low-income housing credits. These final and temporary regulations affect owners of low-income housing projects, tenants in those projects, and State or local housing credit agencies that monitor compliance with the requirements for low-income housing credits.

Finding Lists begin on page ii.

The IRS Mission

Provide America's taxpayers top-quality service by helping them understand and meet their tax responsibilities and enforce the law with integrity and fairness to all.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1986 Code.
This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1986.

Part II.—Treaties and Tax Legislation.
This part is divided into two subparts as follows: Subpart A, Tax Conventions and Other Related Items, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.
To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts. Also included in this part are Bank Secrecy Act Administrative Rulings. Bank Secrecy Act Administrative Rulings are issued by the Department of the Treasury's Office of the Assistant Secretary (Enforcement).

Part IV.—Items of General Interest.
This part includes notices of proposed rulemakings, disbarment and suspension lists, and announcements.

The last Bulletin for each month includes a cumulative index for the matters published during the preceding months. These monthly indexes are cumulated on a semiannual basis, and are published in the last Bulletin of each semiannual period.

Part I

Rev. Rul. 2022-19

For purposes of the taxation of fringe benefits under section 61 of the Internal Revenue Code, section 1.61-21(g) of the Income Tax Regulations provides a rule for valuing noncommercial flights on employer-provided aircraft. Section 1.61-21(g)(5) provides an aircraft valuation formula to determine the value of such flights. The value of a flight is determined under the base aircraft valuation formula (also known as the Standard Industry Fare Level formula or SIFL) by multiplying the SIFL cents-per-mile rates applicable for the period during which the flight was taken by the appropriate aircraft multiple provided in section 1.61-21(g)(7) and then adding the applicable terminal charge. The SIFL cents-per-mile rates in the formula and the terminal charge are calculated by the Department of Transportation (DOT) and are reviewed semi-annually.

According to DOT, due to the effect of the COVID-19 pandemic, airline industry capacity (as measured by airline seat miles) was reduced faster than airline industry expenses were reduced. Generally, the SIFL rate is the result of airline industry expenses divided by airline seat miles. Because airline seat miles were reduced faster than airline industry expenses, the SIFL rate for the 6-month Tax Period Effective 1/1/2021 increased substantially.

Furthermore, in March 2020, the Coronavirus Aid, Relief, and Economic Security Act was enacted, directing the Treasury Department to allot up to $25 billion for domestic carriers to cover payroll expenses via grants and promissory notes, known as the Payroll Support Program (PSP). The PSP grants and PSP promissory notes offset airline industry expenses. Accordingly, DOT provided two alternatives to incorporate differing levels of the PSP into the SIFL rate calculations to both account for the PSP in the rate calculations and to mitigate the pandemic impact on the SIFL rate. One calculation adjusts the SIFL rates to account for PSP grants only while the other calculation adjusts the SIFL rates to account for both the PSP grants and PSP promissory notes.

This revenue ruling contains these three SIFL rates: (1) the Unadjusted SIFL Rate, (2) the SIFL Rate Adjusted for PSP Grants, and (3) the SIFL Rate Adjusted for PSP Grants and Promissory Notes. Taxpayers may use any of the three rates when determining the value on noncommercial flights of employer-provided aircraft under section 1.61-21(g).

The following charts set forth the terminal charges and SIFL mileage rates:

Period During Which the Flight Is Taken	*Terminal Charge*	*SIFL Mileage Rates*
Unadjusted SIFL Rate		
7/1/22 - 12/31/22	$44.18	Up to 500 miles = $.2417 per mile
		501-1500 miles = $.1843 per mile
		Over 1500 miles = $.1771 per mile
SIFL Rate Adjusted for PSP Grants		
7/1/22 - 12/31/22	$44.97	Up to 500 miles = $.2460 per mile
		501-1500 miles = $.1875 per mile
		Over 1500 miles = $.1803 per mile
SIFL Rate Adjusted for PSP Grants and Promissory Notes		
7/1/22 - 12/31/22	$46.83	Up to 500 miles = $.2562 per mile
		501-1500 miles = $.1953 per mile
		Over 1500 miles = $.1878 per mile

DRAFTING INFORMATION

The principal author of this revenue ruling is Kathleen Edmondson of the Office of Associate Chief Counsel (Employee Benefits, Exempt Organizations and Employment Taxes). For further information regarding this revenue ruling, contact Ms. Edmondson at (202) 317-6798 (not a toll-free number).

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26 CFR 300.0 (amended), 300.5 (amended), 300.6 (amended), and 300.10 (amended)

T.D. 9966

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 300

User Fees Relating to Enrolled Agents and Enrolled Retirement Plan Agents

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: These final regulations amend existing regulations relating to user fees for enrolled agents and enrolled retirement plan agents. The final regulations increase the renewal user fee for enrolled retirement plan agents from $67 to $140. In addition, the final regulations increase both the enrollment and renewal of enrollment user fees for enrolled agents from $67 to $140. These regulations affect individuals who are or apply to become enrolled agents and individuals who are enrolled retirement plan agents. The Independent Offices Appropriation Act of 1952 authorizes charging user fees.

DATES: *Effective date:* These regulations are effective October 31, 2022.

Applicability date: For the date of applicability, see §§ 300.5(d), 300.6(d), and 300.09(d).

FOR FURTHER INFORMATION CONTACT: Mark Shurtliff at (202) 317-6845 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains amendments to the regulations in 26 CFR part 300 – User Fees. On March 1, 2022, a notice of proposed rulemaking (REG-114209-21) and notice of public hearing was published in the **Federal Register** (87 FR 11366). The document proposed amending the regulations relating to the user fees for enrolled agents and enrolled retirement plan agents. The document proposed increasing the amount of the renewal user fee for enrolled retirement plan agents from $67 to $140. In addition, the document proposed increasing both the enrollment and renewal of enrollment user fees for enrolled agents from $67 to $140. The notice contains a detailed explanation of the legal background and user fee calculations regarding the amendments to these regulations.

Six comments responding to the notice of proposed rulemaking were received, including comments from the National Association of Enrolled Agents (NAEA). On May 3, 2022, representatives from the NAEA, Department of the Treasury (Treasury Department), the IRS, and the Small Business Administration (SBA), held a teleconference to listen to NAEA's comments about the proposed rulemaking. In addition, two requests to speak at the scheduled public hearing were received. A public hearing was held on May 11, 2022. After consideration of the written comments, teleconference comments, and testimony at the public hearing, the Treasury Department and the IRS have decided to adopt without modification the regulations proposed by the notice of proposed rulemaking.

Summary of Comments

The six comments submitted in response to the notice of proposed rulemaking and a summary of the teleconference comments are available at www.regulations.gov or upon request. Some of the comments that were submitted did not seek modification or clarification of the user fee as set forth in the proposed regulations. One commenter expressed concern with how the special enrollment examination for enrolled agents (EA SEE) is being administered. The commenter also recommended using the user fees in these regulations to provide resources for tax professionals that would improve the service they provide to their clients. The user fees in these regulations are not used by the Treasury Department or the IRS to administer the EA SEE, or to provide resources for tax professionals that improve the service they provide to their clients. Therefore, comments regarding the EA SEE and additional resources identified by the commenter are outside the scope of these regulations. Another commenter suggested that the IRS should raise the amount of the user fee to apply for or renew a preparer tax identification number (PTIN) in order to (1) lower the cost of user fees relating to enrolled agents and (2) encourage more individuals to become enrolled agents. These regulations do not relate to the PTIN user fee or the PTIN program. Therefore, comments regarding the PTIN program and related user fees are outside the scope of these regulations. Finally, one commenter suggested that it is inconsistent for the IRS to charge user fees in order to administer the enrollment and renewal of enrollment program but not charge user fees for other programs (for example, participation in the Annual Filing Season Program). Again, comments regarding programs other than the enrollment and renewal of enrollment program are outside the scope of these regulations. The summary of comments below addresses those comments that make recommendations concerning or seeking clarification of the user fees set forth in the proposed regulations relating to the user fees for enrolled agents and enrolled retirement plan agents.

A. *Amount of User Fees*

Four commenters expressed concern with the overall amount of the proposed enrollment and renewal of enrollment user fees and requested information regarding why the user fees are required.

The Independent Offices Appropriation Act of 1952 (IOAA) (31 U.S.C. 9701) authorizes each agency to promulgate regulations establishing the charge for services provided by the agency. The

IOAA states that the services provided by an agency should be self-sustaining to the extent possible. 31 U.S.C. 9701(a). The IOAA provides that user fee regulations are subject to policies prescribed by the President, which are currently set forth in the Office of Management and Budget (OMB) Circular A-25 (OMB Circular), 58 FR 38142 (July 15, 1993).

Section 6a(1) of OMB Circular A-25 states that when a service offered by a Federal agency provides special benefits to identifiable recipients beyond those accruing to the general public, the agency should establish a user fee to recover the full cost of providing the service. An agency that seeks to impose a user fee for government-provided services must calculate the full cost of providing those services.

In accordance with OMB Circular A-25, the IRS Return Preparer Office (RPO) completed its 2021 biennial review of the enrollment and renewal of enrollment user fees associated with enrolled agents and enrolled retirement plan agents. As discussed in the notice of proposed rulemaking, during its review the RPO took into account the increase in labor, benefits, and overhead costs incurred in connection with providing enrollment services to individuals who enroll or renew enrollment as enrolled agents and renew enrollment as enrolled retirement plan agents since the user fee was last increased in 2019. The proposed increase took into account the additional staffing that allows the RPO to provide a higher quality of service to individuals seeking to enroll or renew enrollment. The RPO also took into account a reallocation of certain labor costs in their methodology. The RPO followed the generally accepted accounting principles established by the Federal Accounting Standards Advisory Board. The RPO determined that the full cost of administering the program for enrolled agents and enrolled retirement plan agents has increased from $67 to $140 per application for enrollment or renewal of enrollment. That amounts to a $73 increase per application for enrollment or renewal of enrollment. The enrollment user fee is a one-time cost, and renewal of enrollment user fees are due once every three years, so the increase amounts to an additional $24.33 per year.

B. *OMB Circular A-25 Requirements*

Two of the commenters stated that the IRS did not fully comply with OMB Circular A-25. Two of the commenters questioned whether the service related to the user fees in these regulations confers a special benefit on enrolled agents and enrolled retirement plan agents. One of the commenters indicated that the service the IRS provides under these regulations benefits the general public rather than a specific beneficiary (that is, enrolled agents and enrolled retirement plan agents). Finally, two of the commenters stated that OMB Circular A-25 allows for an exception to the user fee requirement.

The Treasury Department and the IRS disagree with the comments regarding OMB Circular A-25. Section 6a(1) of OMB Circular A-25 states that when a service offered by a Federal agency provides special benefits to identifiable recipients beyond those accruing to the general public, the agency should establish a user fee to recover the full cost of providing the service. An agency that seeks to impose a user fee for government-provided services must calculate the full cost of providing those services. Under OMB Circular A-25, a user fee should be set at an amount that recovers the full cost of providing a service, unless the OMB grants an exception. The full cost of providing a service includes both the direct and indirect costs of providing the service.

The IRS provides enrollment and renewal of enrollment services to specific, identifiable recipients: enrolled agents and enrolled retirement plan agents. An individual who has been granted enrollment as an enrolled agent or an enrolled retirement plan agent may practice before the IRS, including representing taxpayers. The IRS confers benefits on individuals who are enrolled agents or enrolled retirement plan agents beyond those that accrue to the general public by allowing them to practice before the IRS. Because the ability to practice before the IRS is a special benefit that does not accrue to the general public, the IRS charges a user fee to recover the full cost associated with administering the enrollment and renewal of enrollment program.

An agency is required to set the user fee at an amount that recovers the full cost of providing the service unless the agency requests, and the OMB grants, an exception to the full-cost requirement. Under section 6c(2) of OMB Circular A-25, the OMB may grant exceptions when the cost of collecting the fees would represent an unduly large part of the fee for the activity or when any other conditions exist that, in the opinion of the agency head, justifies an exception. When the OMB grants an exception, the agency does not collect the full cost of providing the service and must fund the remaining cost of providing the service from other available funding sources. Consequently, the agency subsidizes the cost of the service to the recipients of reduced-fee services even though the service confers a special benefit on those recipients who would otherwise be required to pay the full cost of receiving the benefit as provided by OMB Circular A-25. The cost of collecting the user fees in these regulations does not represent an unduly large part of the fee. In addition, the Treasury Department and the IRS have not identified any conditions that exist that would justify an exception to the full-cost requirement. Therefore, it is appropriate for the IRS to recover the full cost it incurs to provide enrollment and renewal of enrollment services to individuals seeking to practice before the IRS as enrolled agents or enrolled retirement plan agents.

C. *Justification for Increasing the User Fees*

One of the commenters expressed concern with the amount by which the user fees have increased since 2019. Specifically, user fees were increased from $30 to $67 in 2019, and the notice of proposed rulemaking for these final regulations proposed to increase the user fees from $67 to $140. The commenter questioned how the RPO's reallocation of labor costs could account for the increases.

The amount of the user fee increases can be explained, in part, by certain reallocations of labor costs and how other user fees have affected the user fees relating to the enrollment and renewal of enrollment program for enrolled agents and enrolled retirement plan agents. On September 30, 2010, the Treasury Department and the IRS published two final regulations in the **Federal Register**: (1) final regulations

(TD 9501, 75 FR 60309) that required tax return preparers who prepare for compensation all or substantially all of a tax return or claim for refund to obtain a PTIN and (2) final regulations (TD 9503, 75 FR 60316) that required a user fee to apply for or renew a PTIN. Individuals applying for, or renewing, a PTIN were to be subject to Federal tax-compliance and suitability checks and were required to pay a $50 user fee (plus an additional amount payable directly to a third-party vendor) to obtain or renew a PTIN. All enrolled agents and certain enrolled retirement plan agents were required to obtain a PTIN as a condition of enrollment and renewal of enrollment. TD 9527, 76 FR 32286; Notice 2011-91, 2011-47 I.R.B. 792. On April 19, 2011, the Treasury Department and the IRS published in the **Federal Register** (76 FR 21805) a final regulation (TD 9523) that reduced the amount of the user fees for the initial enrollment and renewal of enrollment for enrolled agents and enrolled retirement plan agents from $125 to $30. The user fee to enroll or renew enrollment was reduced because certain procedures, including Federal tax-compliance and suitability checks, which were previously performed as part of the enrolled agent and enrolled retirement plan agent enrollment application process, were to be performed as part of the required process to obtain a PTIN.

As required by the IOAA and OMB Circular A-25, the RPO conducted a biennial review of the enrollment and renewal of enrollment user fees associated with enrolled agents and enrolled retirement plan agents in 2017. During its review the RPO took into account the increase in labor, benefits, and overhead costs incurred in connection with providing services to individuals who enroll or renew enrollment as enrolled agents and enrolled retirement plan agents since the user fee was changed in 2011. In addition, the RPO determined that costs associated with Federal tax-compliance checks and suitability checks on applicants for enrollment and renewal should be recovered as part of the user fee for administering the enrollment and renewal of enrollment programs (and not the PTIN user fee). The 2017 biennial review also took into account new costs associated with administering the program for enrolled agents and enrolled retirement plan agents, including the costs of operating a dedicated toll-free helpline in the RPO for enrollment and renewal of enrollment matters. The RPO determined that the full cost of administering the program for enrolled agents and enrolled retirement plan agents had increased from $30 to $67 per application for enrollment or renewal of enrollment. On May 13, 2019, the Treasury Department and the IRS published in the **Federal Register** (84 FR 20801-01) a final regulation (TD 9858) that established the current $67 user fee per enrollment or renewal of enrollment. The user fee complied with the directive in OMB Circular A-25 to recover the full cost of providing a service that confers special benefits on identifiable recipients beyond those accruing to the general public.

The user fees for enrollment and renewal of enrollment were $125 prior to the RPO's reallocation of certain labor costs related to the PTIN user fee in 2011. The proposed user fee of $140 recovers many of the same costs associated with the RPO's administration of the enrollment and renewal of enrollment program that were recovered in the enrollment and renewal of enrollment user fees prior to the reallocation of certain labor costs to the PTIN user fee, as well as additional staffing and services the RPO currently provides associated with enrollment and renewal of enrollment. Even though the RPO has increased its staff to provide a higher quality of service, and now provides additional services, the user fee for enrollment and renewal of enrollment is only $15 more than the enrollment and renewal of enrollment fees in 2011.

One of the commenters expressed concern about the number of full-time equivalent (FTE) employees assigned to the enrollment and renewal of enrollment program, FTE activities, and the ratio of managers to staff employees. The commenter stated that there were 17 FTEs assigned to the enrollment and renewal of enrollment program, including three managers and 14 staff employees. The commenter questioned whether that number of managers and FTEs was necessary to administer the enrollment and renewal of enrollment program.

The employment and management figures cited by the commenter are not accurate. There are 14 employees assigned entirely to the enrollment and renewal of enrollment program, including two managers that oversee the 12 other employees. One of the managers is a director who oversees five FTEs, but only two of those FTEs are assigned fully to the enrollment and renewal of enrollment program (and whose salary, benefits, and associated overhead are charged to the enrollment and renewal of enrollment program). Because the director oversees three FTEs who are not fully assigned to the enrollment and renewal of enrollment program, not all of the director's salary is charged to the enrollment and renewal of enrollment program. The other manager is a frontline manager who oversees 10 FTEs, all of whom are dedicated entirely to the enrollment and renewal of enrollment program.

The IRS determines the cost of its services and the activities involved in producing them through a cost-accounting system that tracks costs to organizational units. The lowest organizational unit in the IRS's cost-accounting system is called a cost center. There are two cost centers related to the enrollment and renewal of enrollment program: the Policy and Management Cost Center and the Enrollment Cost Center. The Policy and Management Cost Center includes three FTEs: one director, one senior analyst, and one administrative assistant. The director oversees the entire enrollment and renewal of enrollment program. The senior analyst manages inventory, handles system administrator duties for the toll-free helpline, and is responsible for reporting requirements for the enrollment and renewal of enrollment program. The administrative assistant provides administrative support to the director and staff, processes mail (including applications, checks, and general correspondence), uploads mail to be distributed to legal instrument examiners, and other administrative support duties (including managing the director's calendar and filing personnel documents).

The Enrollment Cost Center includes one manager, one clerk, and nine legal instrument examiners. The manager is responsible for work assignments, work reviews, employee evaluations, leave approvals, and other managerial tasks. The clerk processes mail, prints and mails enrollment and renewal of enrollment certificates and cards, updates enrolled agent and enrolled retirement plan agent account information, makes electronic copies of paper documents, and provides clerical assistance with issuing notices to enrolled agents and enrolled retirement plan agents. The nine legal instrument examiners process enrollment and renewal of enrollment forms, make referrals to the RPO's suitability department for Federal tax-compliance checks and criminal background checks (if necessary), document findings and eligibility status in the RPO's case-tracking software, answer calls on the toll-free helpline, and respond to emails from enrolled agents and enrolled retirement plan agents. In addition, to improve the level of service for processing, the toll-free telephone operations staffing has increased, quality review programs have been implemented, and correspondence backlogs have been eliminated.

The RPO has determined that these managers and other employees are necessary to effectively administer the enrollment and renewal of enrollment program and provide high-quality service to individuals seeking to enroll or renew enrollment.

The same commenter also questioned a reallocation of costs that partially accounted for the proposed increased fee for enrollment or renewal of enrollment. This reallocation refers to a portion of oversight and support costs that had previously been recovered through other funding sources. During the biennial review, the RPO determined that these costs were associated with the enrollment and renewal of enrollment program and thus were appropriately recovered through the enrollment and renewal of enrollment user fees.

D. *Impact of User Fees on Enrollment and Renewal of Enrollment of Enrolled Agents and Enrolled Retirement Plan Agents*

Four of the commenters opined that the Treasury Department and the IRS should take into account that enrolled agents help improve the Federal tax system. For example, enrolled agents are required to take continuing education courses, which enable them to accurately prepare tax returns and efficiently resolve taxpayer disputes with the IRS. The four commenters expressed concern that the proposed user fee increases may discourage individuals from enrolling as enrolled agents or renewing their enrollment.

The Treasury Department and the IRS recognize the valuable service enrolled agents and enrolled retirement plan agents provide to taxpayers as well as the contributions they make to improving the Federal tax system. As discussed in Section A of this preamble, despite the service enrolled agents and enrolled retirement plan agents provide to taxpayers, OMB Circular A-25 states that when a service offered by a Federal agency provides special benefits to identifiable recipients beyond those accruing to the general public, the agency should establish a user fee to recover the full cost of providing the service (unless the agency requests, and the OMB grants, an exception to the full-cost requirement). As discussed in Section B of this preamble, the IRS confers benefits on individuals who are enrolled agents and enrolled retirement plan agents beyond those that accrue to the general public by allowing them to practice before the IRS. The Treasury Department and the IRS comply with OMB Circular A-25 by charging user fees to recover the full cost of overseeing the enrollment and renewal of enrollment program. The Treasury Department and the IRS have not requested an exception from the OMB because there is no data that indicates that the user fee for enrollment or renewal of enrollment is cost prohibitive or that any other condition exists that justifies an exception.

E. *Regulatory Flexibility Act (RFA) Compliance*

One commenter stated that the Treasury Department and the IRS should have conducted an initial regulatory flexibility analysis pursuant to the RFA, based on the assumption that these regulations will have a significant economic impact on a substantial number of small entities. The commenter explained that it surveyed the enrolled agent community and found that 53 percent of enrolled agents are sole practitioners and 46 percent work for a firm. In the commenter's view, sole proprietorships should be considered small entities and the firms that employ enrolled agents (which sometimes reimburse enrolled agents for their user fees) are generally small businesses. Therefore, the commenter concluded that the user fees in these regulations would have a significant economic impact on a substantial number of small entities.

The Treasury Department and the IRS disagree that these regulations will have a significant economic impact on a substantial number of small entities. As discussed in the notice of proposed rulemaking, only individuals, not businesses, can be enrolled agents or enrolled retirement plan agents. Accordingly, the user fee primarily affects individuals who are enrolled agents, apply to become enrolled agents, or are enrolled retirement plan agents.

Since individuals are not "small entities" for purpose of the RFA, any economic impact of the user fees on small entities generally will occur only when an enrolled agent or enrolled retirement plan agent owns a small business or when a small business employs enrolled agents or enrolled retirement plan agents and reimburses them for their user fees.

Even if a substantial number of small businesses are affected by reimbursing enrolled agents or enrolled retirement plan agents for their user fees, a regulatory flexibility analysis would not be required because the economic impact on small entities is not significant. The economic impact on any small entities affected would be limited to paying, triennially, the $73 difference in cost between the $140 user fee and the previous $67 user fee (for each enrolled agent or enrolled retirement plan agent who a small entity employs and reimburses).

The RFA does not define the term "significant economic impact;" however, the SBA has provided guidance for government agencies on how to comply with the RFA, including determining whether a regulation will have a significant economic impact. The SBA's guidance is available at https://cdn.advocacy.sba.gov/wp-content/uploads/2019/06/21110349/How-to-Comply-with-the-RFA.pdf. The SBA's guidance explains that one measure for determining the economic impact is the percentage of revenue or percentage of gross revenues affected. For example, if the cost of implementing a particular rule represents three percent of the profits in a particular sector of the economy and the profit margin in that industry is two percent of gross revenues (an economic structure that occurs in the food marketing industry, where profits are often less than two percent), the implementation of the proposal would drive many businesses out of business (all except the ones that beat a three percent profit margin). According to the SBA's guidance, the regulation in this example would have a significant economic impact.

The SBA's guidance further explains that the economic impact does not have to completely erase profit margins to be significant. For example, the implementation of a rule might reduce the ability of the firm to make future capital investment, thereby severely harming its competitive ability, particularly against larger firms. This scenario may occur in the telecommunications industry, where a regulatory regime that harms the ability of small companies to invest in needed capital will not put them out of business immediately, but over time may make it impossible for them to compete against companies with significantly larger capitalizations. The impact of that rule would then be significant for smaller telecommunications companies.

Finally, the SBA's guidance explains that other measures may be used. For example, the impact could be significant if the cost of the proposed regulation (a) eliminates more than 10 percent of the businesses' profits; (b) exceeds one percent of the gross revenues of the entities in a particular sector; or (c) exceeds five percent of the labor costs of the entities in the sector.

While data relevant to the SBA's guidance is limited, the Treasury Department and the IRS have carefully considered public information related to the economic impact of the proposed user fees. For example, Surgent, an organization that provides preparation courses for the EA SEE, states on its website at http://www.surgent.com that the average salary for an enrolled agent as of December 2021 is $59,020. The triennial user fee for enrolled agents and enrolled retirement plan agents is $140, or approximately $47 per year. Thus, the annualized cost of enrollment as an EA is approximately 0.0008 percent of the average yearly salary of an enrolled agent. The triennial user fee has increased from $67 to $140 per application for enrollment or renewal of enrollment. That amounts to a $73 increase per application for enrollment or renewal of enrollment. The increase amounts to $24.33 per year, or 0.0004 percent of the average yearly salary of an enrolled agent.

Based on the foregoing considerations, the Treasury Department and the IRS conclude that the rule is not expected to have a significant economic impact on a substantial number of small entities, and a regulatory flexibility analysis is not required.

After consideration of the comments, the proposed regulations are adopted without change.

Special Analyses

I. *Regulatory Planning and Review*

These regulations are not significant and are not subject to review under section 6(b) of Executive Order 12866 pursuant to the Memorandum of Agreement (April 11, 2018) between the Treasury Department and the OMB regarding review of tax regulations.

II. *Regulatory Flexibility Act*

Pursuant to the RFA (5 U.S.C. chapter 6), it is hereby certified that these regulations will not have a significant economic impact on a substantial number of small entities. As discussed in Section E of this preamble, the Treasury Department and the IRS have determined that the rule is not expected to have a significant economic impact on a substantial number of small entities and a regulatory flexibility analysis is not required.

Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking was submitted to the Chief Counsel of the Office of Advocacy of the SBA for comment on its impact on small business. The Chief Counsel for the Office of Advocacy of the SBA did not provide any written comments; however, they reached out to the Treasury Department and the IRS regarding comments they received from the NAEA.

III. *Unfunded Mandates Reform Act*

Section 202 of the Unfunded Mandates Reform Act of 1995 (UMRA) requires that agencies assess anticipated costs and benefits and take certain other actions before issuing a final rule that includes any Federal mandate that may result in expenditures in any one year by a state, local, or tribal government, in the aggregate, or by the private sector, of $100 million in 1995 dollars, updated annually for inflation. This rule does not include any Federal mandate that may result in expenditures by state, local, or tribal governments, or by the private sector in excess of that threshold.

IV. *Executive Order 13132: Federalism*

Executive Order 13132 (Federalism) prohibits an agency from publishing any rule that has federalism implications if the rule either imposes substantial, direct compliance costs on state and local governments, and is not required by statute, or preempts state law, unless the agency meets the consultation and funding requirements of section 6 of the Executive order. These final regulations do not have federalism implications and do not impose substantial direct compliance costs on state and local governments or preempt state law within the meaning of the Executive order.

Drafting Information

The principal author of these regulations is Mark Shurtliff, Office of the Associate Chief Counsel (Procedure and Administration). Other personnel from the Treasury Department and the IRS participated in the development of the regulations.

List of Subjects in 26 CFR Part 300

Reporting and recordkeeping requirements, User fees.

Adoption of Amendments to the Regulations

Accordingly, the Treasury Department and the IRS amend 26 CFR part 300 as follows:

PART 300 — USER FEES

Paragraph. 1. The authority citation for part 300 continues to read as follows:

Authority: 31 U.S.C. 9701.

Par. 2. Section 300.5 is amended by revising paragraphs (b) and (d) to read as follows:

§300.5 Enrollment of enrolled agent fee.

* * * * *

(b) *Fee*. The fee for initially enrolling as an enrolled agent with the IRS is $140.

* * * * *

(d) *Applicability date*. This section is applicable beginning October 31, 2022.

Par. 3. Section 300.6 is amended by revising paragraphs (b) and (d) to read as follows:

§300.6 Renewal of enrollment of enrolled agent fee.

* * * * *

(b) *Fee*. The fee for renewal of enrollment as an enrolled agent with the IRS is $140.

* * * * *

(d) *Applicability date*. This section is applicable beginning October 31, 2022.

Par. 4. Section 300.9 is amended by revising paragraphs (b) and (d) to read as follows:

§300.9 Renewal of enrollment of enrolled retirement plan agent fee.

* * * * *

(b) *Fee*. The fee for renewal of enrollment as an enrolled retirement plan agent with the IRS is $140.

* * * * *

(d) *Applicability date*. This section is applicable beginning October 31, 2022.

Paul J. Mamo,
Assistant Deputy Commissioner for Services and Enforcement.

Approved: September 20, 2022.

Lily L. Batchelder,
Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on September 27, 2022, 8:45 a.m., and published in the issue of the Federal Register for September 29, 2022, 87 F.R. 58968)

26 CFR 1.42-15, 26 CFR 1.42-19

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

T.D. 9967

Section 42, Low-Income Housing Credit Average Income Test Regulations

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains final and temporary regulations setting forth guidance on the average income test for purposes of the low-income housing credit. If a building is part of a residential rental project that satisfies this test, the building may be eligible to earn low-income housing credits. These final and temporary regulations affect owners of low-income housing projects, tenants in those projects, and State or local housing credit agencies that monitor compliance with the requirements for low-income housing credits.

DATES: *Effective date*: These regulations are effective on October 12, 2022.

Applicability date: For the applicability date of the temporary regulations, see §1.42-19T(f).

FOR FURTHER INFORMATION CONTACT: Dillon Taylor at (202) 317-4137.

SUPPLEMENTARY INFORMATION:

Background

This document contains amendments to the Income Tax Regulations (26 CFR part 1) under section 42 of the Internal Revenue Code (the Code).

The Tax Reform Act of 1986, Pub. L. 99-514, 100 Stat. 2085 (1986 Act), created the low-income housing credit under section 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 (effectively, a credit rate) 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 section 42(d)). Section 42(c)(1)(B) defines applicable fraction as the smaller of the unit fraction or floor space fraction. The unit fraction is the number of low-income units in the building over the number of residential rental units (whether or not occupied) in the building. The floor space fraction is the total floor space of low-income units in the building over the total floor space of residential rental units (whether or not occupied) in the building. Subject to certain exceptions set forth in section 42(i)(3)(B), a low-income unit is defined in section 42(i)(3) as any unit in a building if the unit is rent-restricted and the individuals occupying the unit meet the income limitation under section 42(g)(1) that applies to the project of which the building is a part. Section 42(d)(1) and (2) define the eligible basis of a new building or an existing building, respectively.

Section 42(c)(2) defines a qualified low-income building as any building which 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 section 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. 115-141, 132 Stat. 348 (2018 Act), section 42(g) set forth two minimum set-aside tests, known as the 20-50 test and the 40-60 test. If a taxpayer elects to apply 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). If a taxpayer elects to apply 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.

The 2018 Act added section 42(g)(1)(C), which contains a third minimum set-aside test option—the average income test. If a taxpayer elects to apply the average income test, a project meets the minimum requirements of the average income test if 40 percent or more 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 specific unit. (In the case of a project described in section 142(d)(6), "40 percent" in the preceding sentence is replaced with 25 percent.) Section 42(g)(1)(C)(ii)(I)-(III) provides special rules relating to the income limitation for the average income test. Specifically, unlike the 20-50 and 40-60 tests, section 42(g)(1)(C)(ii)(I) requires the taxpayer to designate each unit's imputed income limitation that is taken into account for purposes of the average income test. Section 42(g)(1)(C)(ii)(II) requires the average of the imputed income limitations designated under section 42(g)(1)(C)(ii)(I) not to exceed 60 percent of AMGI. Finally, section 42(g)(1)(C)(ii)(III) requires the imputed income limitation designated for any unit to be 20, 30, 40, 50, 60, 70, or 80 percent of AMGI.

Generally, under section 42(g)(2)(D)(i), if the income for the occupant of a low-income unit rises above the relevant income limitation, the unit continues to be treated as a low-income unit if the income of the occupant had initially met the income limitation and the unit continues to be rent-restricted. Section 42(g)(2)(D)(ii), however, provides an exception to the general rule in the case of the 20-50 test or the 40-60 test. Under this exception, the unit ceases to be treated as a low-income unit if two disqualifying conditions occur.

- The first condition is that the occupant's income increases above 140 percent of the income limitation applicable under section 42(g)(1) (applicable income limitation).
- The second condition is that a new occupant whose income exceeds the applicable income limitation occupies any residential rental unit in the building of a comparable or smaller size.

In the case of a deep rent skewed project described in section 142(d)(4)(B) of the Code "170 percent" is substituted for "140 percent" in applying the applicable income limitation under section 42(g)(1), and the second condition is that any low-income unit in the building is occupied by a new resident whose income exceeds 40 percent of AMGI.

The exception contained in section 42(g)(2)(D)(ii) is referred to as the next available unit rule. *See also* §1.42-15 of the Income Tax Regulations.

The 2018 Act added a new next available unit rule in section 42(g)(2)(D)(iii), (iv), and (v) for situations in which the taxpayer has elected the average income test. Under this new rule, a unit ceases to be a low-income unit if two slightly different disqualifying conditions are met:

- First, the income of an occupant of a low-income unit increases above 140 percent of the greater of (i) 60 percent of AMGI, or (ii) the imputed income limitation designated by the taxpayer with respect to the unit; and
- Second, a new occupant whose income exceeds the applicable imputed income limitation occupies any other residential rental unit in the building that is of a comparable or smaller size. The applicable imputed income limitation for this purpose depends upon whether the unit being occupied was a low-income unit before becoming vacant.
    - o If the new tenant occupies a unit that was taken into account as a low-income unit prior to becoming vacant, section 42(g)(2)(D)(v)(I) provides that the applicable imputed income limitation is the limitation designated with respect to the unit.
    - o If the new tenant occupies a market-rate unit, section 42(g)(2)(D)(v)(II) provides that the applicable imputed income limitation is "the imputed income limitation which would have to be designated with respect to such unit under [section 42(g)(1)(C)(ii)(I)] in order for the project to continue to meet the requirements of [section 42(g)(1)(C)(ii)(II)]." (Those requirements mandate that the "average of the imputed income limitations designated under [section 42(g)(1)(C)(ii)(I)] shall not exceed 60 percent of" AMGI.)

Section 42(g)(2)(D)(iv) also provides a next available unit rule for deep rent skewed projects that elect the average income test.

Under section 42(g), once a taxpayer elects to use a particular set-aside test for a project, that election is irrevocable. Thus, if a taxpayer had previously elected to use the 20-50 test or the 40-60 test, the taxpayer may not subsequently elect to use the average income test. Under section 42(g)(4), the rules of sections 142(d)(2)(B) through (E), 142(d)(3) through (7), and 6652(j) of the Code apply to determine whether any project is a qualified low-income housing project and whether any unit is a low-income unit.

Section 42(m)(1) provides that the owners of an otherwise-qualifying building are not entitled to the housing credit dollar amount that is allocated to the building unless, among other requirements, the allocation is pursuant to a qualified allocation plan (QAP). A QAP provides standards by which a State or local housing credit agency (Agency) is to make these allocations. Under section 42(m)(1)(B)(iii), a QAP must contain a procedure that the Agency or its agent will follow in monitoring noncompliance with low-income housing credit requirements and in notifying the IRS of any such noncompliance. See §1.42-5 of the Income Tax Regulations for rules implementing this requirement.

On October 30, 2020, the Department of Treasury (Treasury Department) and the IRS published a notice of proposed rulemaking (NPRM) (REG-119890-18) in the **Federal Register** (85 FR 68816) proposing regulations setting forth guidance on the average income test under section 42(g)(1)(C). The Treasury Department and the IRS received 98 comments, including requests to testify at a public hearing on the proposed regulations and written testimony for the public hearing.

On March 24, 2021, the Treasury Department and the IRS held a public hearing on the proposed regulations. Fifteen taxpayers provided testimony at the hearing.

After consideration of the comments received and the testimony provided, the proposed regulations are adopted as modified by this Treasury Decision. The major areas of comment and the revisions to the proposed regulations are discussed in the following Summary of Comments and Explanation of Revisions. The comments are available for public inspection at www.regulations.gov or upon request. Other minor, non-substantive modifications that were made to the proposed regulations and adopted in these final regulations are not discussed in the Summary of Comments and Explanation of Revisions. In addition, the Treasury Department and the IRS are publishing in this Treasury Decision temporary regulations containing recordkeeping and reporting requirements that are needed to facilitate administrability of, and compliance with, changes made in the final regulations. Those changes were based on comments received on the proposed rule. These requirements are described in this preamble along with the substantive rules contained in the final regulations. The text of these temporary regulations also serves as the text of the proposed regulations (REG–113068-22) set forth in the notice of proposed rulemaking on this subject in the Proposed Rules section of this issue of the **Federal Register**.

Summary of Comments and Explanation of Revisions

These final regulations and temporary regulations set forth guidance on the average income test under section 42(g)(1)(C).

I. Section 1.42-15, Next Available Unit Rule for the Average Income Test

The proposed regulations updated the next available unit provisions in §1.42-15 to reflect the new set-aside based on the average income test and to take into account section 42(g)(2)(D)(iii), (iv), and (v). One commentator recommended that no changes be made to the proposed regulations concerning the next available unit rule when the proposed regulations are finalized. No other comments were received on the next available unit rule.

While no comments requested changes, the final regulations for the next available unit rule were revised to be consistent with changes made to the provisions in §1.42-19, which are described in section II of this Summary of Comments and Explanation of Revisions. The final regulations include revisions to the two limitations in §1.42-15(c)(2)(iv) related to the imputed income designation of the next available unit, which relate to the limitations described in section 42(g)(2)(D)(v). The final regulations provide taxpayers with administrable rules and objective standards to apply when determining the designation of the next available unit. The first limitation in §1.42-15(c)(2)(iv)(A) applies to units that met all of the requirements in §1.42-19(b)(1)(i) through (iii) prior to becoming vacant. In other words, the unit was rent-restricted, the occupants satisfied the imputed income limitation for the unit (or the unit's low-income status continued under section 42(g)(2)(D)), and no other provision in section 42 or the regulations thereunder denied low-income status to the unit. For those units, which would have had a designated imputed income limitation prior to vacancy, the limitation is the unit's designated imputed income limitation. This rule is equivalent to the rule in the proposed regulations, which interpreted the definition of low-income unit as including only the requirements in §1.42-19(b)(1)(i) through (iii). The second limitation in §1.42-15(c)(2)(iv)(B) requires a taxpayer, in the case of any other unit (such as a market-rate unit), to limit the imputed income limitation to a designation that will not cause the average of all imputed income designations of residential units in the project to exceed 60 percent of AMGI. This ensures that the next available unit is designated in such a way that maintains compliance with the averaging requirement in section 42(g)(2)(C)(ii)(II). This revision to the second limitation was necessary because the proposed regulations relied on a reference to the mitigating action provisions, which were removed from the final regulations as explained in section II.B. of this Summary of Comments and Explanation of Revisions.

Additionally, these final regulations provide that, if multiple units are over-income at the same time in a project that has elected the average income set-aside (average income project) and that has a mix of low-income and market-rate units, then the taxpayer need not comply with the next available unit rule in a specific order with respect to occupancy. Instead, renting any available comparable or smaller vacant unit to a qualified tenant maintains all over-income units' status as low-income units until the next comparable or smaller unit becomes available (or, in the case of a deep rent skewed project, the next low-income unit becomes available). The final regulations include an example illustrating the application of this rule. Note, the order in which units are designated, however, may affect the qualified group that is used for computing the applicable fraction. See further discussion in section II.B of this Summary of Comments and Explanation of Revisions.

II. §1.42-19, Average Income Test

A. Requirements to satisfy the average income test

1. Proposed regulations approach to the average income test

The proposed regulations provided that a project for residential rental property meets the requirements of the average income test under section 42(g)(1)(C) if (1) 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 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; (2) the taxpayer designated the imputed income limitations in the manner provided in §1.42-19(b) of the proposed regulations; and (3) the average of the designated imputed income limitations of the low-income units in the project does not exceed 60 percent of AMGI. The proposed regulations would have required taxpayers to complete, not later than the close of the first taxable year of the credit period, the initial designation of imputed income limitations for all of the units taken into account for the average income test.

Under the proposed regulations, the 60 percent of AMGI limit on the average of designated imputed income limitations applied to all of the low-income units in the project. The requirement as so interpreted did not take into account whether fewer than all of those units could constitute a group of at least 40 percent of the residential units in the project such that the average of the limitations of the units in that group averaged to no more than 60 percent of AMGI.

In some cases, this interpretation magnified the adverse consequences of a single unit's failure to maintain low-income status. For example, under the proposed regulations, a unit losing low-income status would remove that unit's imputed income limitation from the computation of the average, but not impact the low-income status of any other units. If that unit's limitation was less than 60 percent of AMGI, the loss of the unit could cause the average of the remaining low-income units to rise above 60 percent of AMGI. That noncompliant average would cause the entire project to fail the average income test and therefore fail to be a qualified low-income housing project. In light of the potential adverse consequences of the rule, the proposed regulations provided for mitigating actions the taxpayer could take within 60 days of the close of the year for which the average income test might be violated.

2. Comments on the proposed set-aside rule

Many commenters disagreed with the adequacy of the proposed mitigation actions and with the correctness of the underlying interpretation of the average income test, which required testing of *all* low-income units.

i. Inadequacy of the proposed mitigation actions

Commenters noted that the mitigation possibilities in the proposed regulations depended on the taxpayer both appreciating that the entire project might be jeopardized by a problem with a particular unit and knowing how to deploy the mitigation actions. Commenters also suggested that the mitigation proposal incorporated such a rigid deadline that even alert and well-advised taxpayers might be unable to timely take mitigating actions to be eligible to receive credits for their projects.

ii. Invalidity of the underlying interpretation

Commenters' central concern was the invalidity, as they saw it, of the underlying interpretation of the average income test. Under the interpretation in the proposed regulations, a single unit's falling out of compliance could result in the complete loss of tax credits for the entire project, or at least loss of credits for an entire year. Commenters noted that this result flowing from the interpretation in the proposed regulations suggested the invalidity of the interpretation. Several commenters observed that the proposed regulations imposed on projects electing the average income test a higher standard than that required for satisfying the other set-aside elections. Under the 20-50 test and 40-60 test, one noncompliant unit could not cause an entire project to fail the set-aside test if, without taking the noncompliant unit into account, there remained a sufficient number of compliant units to meet the statutory minimum percentage of all residential units. The commenters, therefore, concluded that the interpretation in the proposed regulations regarding the average income test could not have been the intent of Congress.

Most commenters recommended that the average income test be satisfied if any group of 40 percent of the units in the project have designations whose average does not exceed 60 percent of AMGI. In general, these commenters correctly asserted that the average income test is a minimum set-aside test, and, therefore, a project should meet the test if the minimum requirements of the test are satisfied, even if low-income units not necessary for the minimum are noncompliant.

Other commenters noted that even though the project should additionally meet an overall average test of no more than 60 percent of AMGI across all low-income units (as required by the proposed regulations), relief should nevertheless be built into the requirement. Thus, if a unit is out of compliance, causing the project-wide average to go above 60 percent of AMGI, the failure should be considered noncompliance for that unit only, and only that non-compliant unit should be subject to credit adjustment and recapture. They urged that this noncompliance should not be a violation of the minimum set-aside, provided that at least 40 percent of the units' designations still meet the 60 percent average.

This suggested approach, however, could create problems similar to those in the proposed regulations because one unit's noncompliance could cause the overall average of the remaining low-income units to rise above 60 percent of AMGI. For this reason, the comment was not adopted, but it was considered in connection with developing the final regulations' rules for determining low-income units and a building's applicable fraction, as is discussed later.

Some commenters believed that the average income test is satisfied as long as the original imputed income limitations of designated low-income units average to 60 percent, and 40 percent or more of those units continue to be rent-restricted and meet their respective imputed income limitations. Thus, the average must be met initially, but subsequently, the requirement is permanently satisfied, regardless of any changes in circumstances related to occupancy. Commenters suggested that a general anti-abuse rule could be adopted to allow the IRS to disregard designations made in bad faith.

The Treasury Department and the IRS do not agree that the averaging requirement of section 42(g)(1)(C)(ii)(II) is concerned only with the original designations. Like the other minimum set-aside tests, the average income test is an ongoing requirement for a project to maintain its status as a qualified low-income housing project. A project failing to maintain an average of 60 percent or less of AMGI across at least 40 percent of its residential units that qualify as low-income units violates the requirement. This is consistent with a plain reading of the statute, as the imputed income limitations of the units taken into account (meaning, counted for purposes of meeting the average income test) must not exceed 60 percent of AMGI. Section 42(g)(1)(C) (ii)(I) and (II). The rejected suggestion would allow an original imputed income limit designation of a subsequently disqualified unit to satisfy compliance with the minimum set-aside test throughout the entire compliance period. Treating such a situation as compliant would effectively waive the rule that a project consistently maintain its level of affordability—a central requirement of the low-income housing credit. Moreover, adoption of a general anti-abuse rule would miss many non-compliant situations, would increase administrative complexity for the IRS and the Agencies and would potentially create uncertainty for taxpayers.

A separate comment recommended that an out-of-compliance unit should maintain its designation if the owner can demonstrate due diligence when completing the initial income certification. The Treasury Department and the IRS disagree with the suggestion that an out-of-compliance unit should not lose its designation if the owner can demonstrate due diligence when completing the initial income certification. Demonstrating due diligence upon initial income certification is not sufficient to satisfy ongoing compliance requirements. Further, similar to a general anti-abuse rule proposed by another commenter, this approach would increase administrative complexity for the IRS and Agencies and could potentially create uncertainty for taxpayers.

3. The final regulations' interpretation of the average income test

In response to the comments received, the Treasury Department and the IRS have revised their interpretation of the set-aside rule and incorporated the revised interpretation in the final regulations. In making these revisions, the Treasury Department and the IRS considered the plain language of section 42(g)(1)(C) as well as the definition of low-income unit for projects electing the average income test. When section 42(g)(1)(C)(i) and the special rules in section 42(g)(1)(C)(ii)(I) and (II) are read together, the taxpayer satisfies the average income test if at least 40 percent of the building's residential units are eligible to be low-income units and have designated imputed income limitations that collectively average 60 percent or less of AMGI. A project satisfying this minimum requirement satisfies the average income test. Thus, the final regulations have been revised so that it is no longer necessary to consider all low-income units in a project for residential rental property when determining whether the average income test is met.

While making this change, the Treasury Department and the IRS also considered the definition of "low-income unit" in a project electing the average income test, and the final regulations provide a clarifying definition of this term. As the final regulations no longer require a taxpayer to consider all of the low-income units in a project in order to satisfy the minimum set-aside requirement, the issue for consideration is whether a project's election of the average income test has any impact on whether a unit that is rent-restricted and whose occupants satisfy the imputed income limitation designated for the unit qualifies as a low-income unit as that term is defined in section 42(i)(3). This determination is relevant for the average income test as well as for purposes of the other provisions of the low-income housing credit, including a building's applicable fraction as explained later.

In defining the term "low-income unit," section 42(i)(3)(A)(ii) requires that 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. With respect to the 20-50 and the 40-60 minimum set-asides, there is no difficulty in applying this language to specific units. Every unit in the project has an identical income limitation, namely the income limitation embodied in the set-aside test that the taxpayer elected for that project. If the taxpayer elects the 20-50 test, then the income limitation for each unit is 50% of AMGI. If the taxpayer elects the 40-60 test, the income limitation for each unit is 60% of AMGI.

For a project electing the average income test, however, the reference to "the income limitation applicable … to the project" poses a challenge because income limitations will typically vary among the units in the project. In addition, pursuant to section 42(g)(1)(C)(ii)(II), the average of the designated imputed income limitations for the units taken into account for meeting the minimum set-side test must not exceed 60% of AMGI. As a result, for purposes of the average income test, the fact that the occupants of a unit satisfy the imputed income limitation designated for that unit does not by itself establish that the unit satisfies the requirements in section 42(i)(3)(A).

The Treasury Department and the IRS considered interpreting the language in section 42(i)(3)(A)(ii) as referring only to the income limitation designated for a specific unit. Such an interpretation would be consistent with the approach under the 20-50 and 40-60 tests where a single unit's noncompliance does not impact the low-income status of any other low-income units in the project. It would also be in accord with many comments that argue the low-income status of one unit should not impact the status of other units if those other units meet their respective income limitations.

In a project electing the average income test, however, it is insufficient to read "the income limitation applicable under [section 42(g)(1)] to the project" as referring only to the designated imputed income limitation applicable to a unit. Under the average income test, a unit's status as a low-income unit for purposes of the set-aside and the applicable fraction depends not only on its own attributes but also on the income limitations of other units that are taken into account for these purposes. In contrast, under the historic set-asides, knowing that a unit satisfies the income limitation applicable to the unit is sufficient to know that the unit meets the project's income limitation for purposes of the minimum set-aside test and a building's applicable fraction.

This interpretation means that to qualify as a low-income unit in a project electing the average income test, a residential unit, in addition to meeting the other requirements to be a low-income unit under section 42(i)(3), must be part of a group of units such that the average of the imputed income limitations of the units in the group does not exceed 60 percent of AMGI. Thus, to provide clarity on the definition of low-income unit for a project electing the average income test, the final regulations include a definition of low-income unit that takes into account whether the unit is a member of a group of units with a compliant average limitation.

This definition of low-income unit in the final regulations is in accord with the definition of low-income unit as originally described in the Conference Report for the Tax Reform Act of 1986 (1986 Conference Report):

> A low-income unit includes any unit in a qualified low-income building if the individuals occupying such unit meet the income limitation elected for the project for purposes of the minimum set-aside requirement and if the unit meets the gross rent requirement, as well as all other requirements applicable to units satisfying the minimum set-aside requirement.

2 H.R. Conf. Rep. 99-841, 99th Cong., 2d Sess., II-94-95.

In that explanation, it is required that a low-income unit meet "all other requirements applicable to units satisfying the minimum set-aside test." Although the average income test was not in existence at the time of the 1986 Conference Report, it is apparent that Congress wanted to avoid creating one standard for low-income units that qualified their projects as part of the 20-50 and 40-60 minimum set-asides and a different standard for any other low-income units that played some other role in the same project. Thus, it is consistent with how low-income units are defined under the 20-50 and 40-60 minimum set-aside tests for these final regulations to require all low-income units in an average income project to satisfy a consistent and equal set of standards—standards that, in the average income context, incorporate the average income limitations of the group of which the units are a part.

Accordingly, under the final regulations, a project for residential rental property meets the requirements of the average income test if the taxpayer's project contains a qualified group of units that constitutes 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 the project. Section 1.42-19(b)(2)(i) requires the units in a qualified group to, first, individually satisfy the criteria that would qualify each unit as a low-income unit under the 20-50 or 40-60 set-asides. Specifically, the rules in §1.42-19(b)(1)(i) through (iii) require that each unit be rent-restricted, occupants of the unit meet the income limitation for the unit, and no other provision in section 42 or the regulations thereunder denies low-income status to the unit (including section 42(i)(3)(B)-(E)). In addition, §1.42-19(b)(2)(ii) requires that the average of the designated imputed income limitations of the units in the group not exceed 60 percent of AMGI. The group of units must be identified as required in §1.42-19(b)(3)(i). A taxpayer identifies the units in the group by recording the units in the taxpayer's books and records, and the taxpayer must communicate that annual identification to the applicable Agency as required in §§1.42-19(b)(3)(iii) and 1.42-19T(c)(1) of the associated temporary regulations. See further description in section II.C of this Summary of Comments and Explanation of Revisions.

These revisions provide more flexibility for meeting the average income test than had been available under the proposed regulations. Most importantly, the revised rules limit the impact of one unit's noncompliance on the ability of a project to satisfy the average income test. The status of additional units beyond the minimum number of units needed to satisfy the test does not impair satisfaction of the average income test as discussed in section II.B of this Summary of Comments and Explanation of Revisions. By removing the proposed requirement applicable to *all* low-income units and thus allowing a project to satisfy the average income test if it contains a qualified group of units meeting the minimum requirements, the final regulations generally avoid the outsized impact that one unit's loss of low-income status could have under the proposed regulations. The interpretation of the average income set-aside in the final regulations is consistent with the majority of comments on this issue.

In addition, this interpretation creates more parallels between the average income test and the 20-50 and 40-60 tests. Under either of those latter tests, when there are more than the minimum number of low-income units, one unit going out of compliance would not cause a project to fail the minimum set-aside test. Similarly, under the final regulations, one unit's loss of low-income status will not jeopardize the entire project's status as a qualified low-income housing project subject to the average income test if there are a sufficient number of remaining units that comprise a qualified group of units that satisfy the minimum set-aside.

B. Determining qualified groups of units for use in applicable fraction determinations

1. Role of the applicable fraction under section 42

As mentioned earlier, the amount of low-income housing credits earned by a building in a taxable year depends on a computation that includes a number called the building's "applicable fraction" for that year. This fraction is based on the number and size of the low-income and non-low-income units in the building and can be thought of as an indicator of the extent to which the building is dedicated to affordable housing. Thus, the applicable fraction plays a role both in determining credits during the credit period and in demonstrating continued dedication to affordable housing during the extended use period. *See* section 42(h)(6)(B)(i).

2. The proposed regulations' resolution of issues posed by computation of the applicable fraction in an average income project

The proposed regulations provided an approach to addressing continuous compliance with the average income requirement by using the same group of low-income units for both satisfying the minimum set-aside requirement and determining the applicable fraction. The proposed regulations also provided for a removed unit, which was a low-income unit identified by the taxpayer that was not taken into account for purposes of the set-aside test or the applicable fraction but was taken into account for purposes of reducing recapture. As described earlier in this Summary of Comments and Explanation of Revisions, taxpayers strongly criticized the set-aside rule. In response, the final regulations both allow the minimum set-aside test to be satisfied by any qualified group of units that is no smaller than the statutory minimum (40 percent) and also add a clarifying definition of "low-income unit" for projects electing the average income test. To implement the statutory requirement regarding the average of the imputed income limitations of residential units in a project, this clarifying definition is sensitive to the imputed income limitations of the other residential units in the same group.

The approach in the final regulations for the average income test differs from the other two set-asides in that the final regulations allow for a distinction between the group of low-income units taken into account for satisfying the minimum set-aside and the (usually larger) group of units taken into account for computing credits. However, under the final regulations, the units included in both groups are subject to the same standards.

Congress acknowledged the absence of such a distinction in the 20-50 and 40-60 tests in its discussion of the low-income housing credit in the 1986 Conference Report:

> Qualified residential rental projects must remain as rental property and must satisfy the minimum set-aside requirement, described above, throughout a prescribed compliance period. Low-income units comprising the qualified basis on which additional credits are based are required to comply continuously with all requirements in the same manner as units satisfying the minimum set-aside requirements. Units in addition to those meeting the minimum set-aside requirement on which a credit is allowable also must continuously comply with the income requirement.

2 H.R. Conf. Rep. 99-841, 99th Cong., 2d Sess., II-95.

Thus, under the 20-50 and 40-60 tests, units included in qualified basis in addition to those needed to satisfy the minimum set-aside must meet the same requirements as the units used to satisfy the minimum set-aside. This application under the 20-50 and 40-60 tests is straightforward, however, because all low-income units have to be at or less than a single elected AMGI standard, either 50 percent or 60 percent of AMGI (assuming other requirements are met). Under either test, the minimum set-aside units and any additional low-income units are effectively interchangeable, so there was no need to clarify treatment between the groups.

For the average income test, however, units are not interchangeable because they have a range of imputed income limitations and cannot be evaluated in isolation because there is an income averaging requirement in section 42(g)(1)(C)(ii)(II). By stating that additional units beyond those meeting the minimum set-aside test must continuously comply with the income requirement, the 1986 Conference Report identified the necessity of developing a common standard for all residential units in projects electing the 20-50 and 40-60 tests. As discussed in section II.A.3 of this Summary of Comments and Explanation of Revisions, this principle is reflected in the final regulations' definition of low-income units, and it impacts the treatment of units that may be taken into account for computing a building's applicable fraction.

3. Comments on determining the applicable fraction

In the context of the 20-50 or 40-60 minimum set-asides, commenters noted, non-compliance by one or more units (for example, not being suitable for occupancy) reduces a building's applicable fraction only with respect to the units that are non-compliant as of the taxpayer's year end. These commenters recommended similar treatment in the average income context. They advocated evaluating eligibility of units for inclusion in the applicable fraction on a unit-by-unit basis (that is, taking into account only facts about the particular unit, without taking into account the designated imputed income limitation of other units).

In the context of removed units, some comments argued that the proposed applicable fraction treatment of these units amounted to "double counting." Not only did the proposed regulations exclude the noncompliant unit from the computation of the applicable fraction of the building containing the unit, but by taking into account the average of the group's income limitations, they could force a taxpayer to exclude one or more compliant units from the applicable fraction(s) of the building(s) containing the compliant unit(s).

The Treasury Department and the IRS considered the proposal to include units in applicable fraction computations on a unit-by-unit basis but did not adopt it. To be sure, that proposal would preserve the requirement that units satisfying the set-aside requirement must have income limitations whose average does not exceed 60 percent of AMGI. The proposal, however, would not apply this average requirement to the units that are taken into account for the project's applicable fractions. The proposed approach would thus be inconsistent with the language of section 42(c)(1)(C)(i), which provides that the numerator of the applicable fraction is number of "low-income units" in the building. As explained earlier in the discussion of the average income test, the definition of low-income unit for a project electing the average income test necessarily includes the requirement that the average of the designated income limitations of the units taken into account as low-income units includes that the average designated income limitations of the units not exceed 60% of AMGI.

In addition, the failure to apply the average income limitation in determining the applicable fraction would allow a taxpayer to include units in the qualified basis even if they are a majority of the units in a project and their average limitation greatly exceeds 60 percent of AMGI. If accepted, the proposal would have allowed a taxpayer to give appropriate income limitations to 40 percent of a project's units but to designate limitations of 80 percent of AMGI for all the remaining low-income units in the project and receive credits for all of these units.

In the context of determining what units to include in the applicable fraction, another commenter recommended revising the proposed regulations to include an exception for units that are not habitable due to a casualty loss, such as from a fire in the unit. The commenter asserted that because the noncompliance was not the fault of taxpayer, the regulations should not require the taxpayer to remove another unit from an applicable fraction to offset the noncompliance associated with the casualty loss. The Treasury Department and the IRS did not adopt this suggestion. An approach that requires a determination of fault would create additional complexity for taxpayers, Agencies, and the IRS. In addition, while the 20-50 and 40-60 set-asides do not have the same issue, adopting rules allowing for special treatment in the case of casualties would necessitate a broader section 42 regulatory project.

4. Determination of the applicable fraction in the final regulations

Under the final regulations, the determination of a group of units to be taken into account in the applicable fractions for the buildings in a project follows the same approach as determining a group of units to be taken into account for purposes of the set-aside test. Essentially, a taxpayer can determine this group of units by including the low-income units identified for the average income test, and any other residential units that can qualify as low-income units if they are part of a group of units such that the average of the imputed income limitations of all of the units in the group does not exceed 60 percent of AMGI. If the average exceeds 60 percent of AMGI, then the group is not a qualified group. For example, if a unit was designated at 80 percent of AMGI and if including that unit in an otherwise qualified group of units causes the average of the imputed income limitations of the group to exceed 60 percent of AMGI, then the taxpayer cannot include the 80 percent unit in the otherwise qualified group. Only the otherwise qualified group of units, without the 80 percent unit, is a qualified group of units used to determine the project's buildings' applicable fractions.

Once a qualified group of units in a project has been identified for a taxable year, the applicable fraction for each building in the project is computed using the units that are in both the qualified group and the building at issue. (Although the qualified group of units for a project must have an average limitation no greater than 60 percent of AMGI, this is not true of the average limitation of the units used to compute the applicable fraction of individual buildings in the project.) This method of determining a building's applicable fraction applies both for ascertaining low-income housing credits earned for a year in the credit period and for complying with the extended use requirement in section 42(h)(6)(B)(i).

The Treasury Department and the IRS determined that the approach to determining the applicable fraction in the final regulations better aligns with the 20-50 and 40-60 set-aside tests than the approach in the proposed regulations in that it creates parallel requirements for both "minimum set-aside units" and any "additional units" that may contribute to earning low-income housing credits. This rule in the final regulations is also consistent with the description of the low-income units and the principle regarding set-aside units and additional units in the other set-aside tests that is described in the 1986 Conference Report discussion quoted earlier. The rule is also consistent with comments stating that the low-income units in a project should have an overall average that does not exceed 60 percent of AMGI.

The potential downside of this approach to an owner is that if one unit loses low-income status, then it is possible that other units' status as low-income units may be impacted. Specifically, an owner may have to exclude one or more otherwise qualifying units from the qualified group of units for use in applicable fraction determinations for the group to retain an average income limitation that does not exceed 60% of AMGI. This, however, will not always be the case. For example, if a unit designated at 60, 70, or 80 percent of AMGI loses low-income status and no other changes occurred, then the owner could maintain the required average limitation of the qualified group of units without excluding any of the other units from the qualified group of units that had been taken into account in the previous year. Also, as is discussed later, in some cases a unit may be included in the qualified group of units after its income limitation has been designated or redesignated to a lower income limitation.

5. Proposed regulations' special rule for determining the applicable fraction for purposes of recapture

The proposed regulations, in some cases, would have caused a compliant low-income unit with a relatively high-income limitation not to have been taken into account in computing low-income housing credits earned for a year in the credit period. The mechanisms for achieving this result were called "mitigating actions" and "removed units". To minimize recapture, the proposed regulations would have included these units in the computations underlying section 42(j) so that the units' inclusion avoided having their absence contribute to recapture of credits. As described in section II.B.6. of this Summary of Comments and Explanation of Revisions, however, the Treasury Department and the IRS deleted the mitigating actions concept from the final regulations. For this reason, the final regulations do not include the proposed regulations' rule related to recapture.

6. Deletion of Mitigating Actions from Final Regulations

As described previously, the proposed regulations would have created a risk that, in some situations, one unit losing its low-income status could have caused an entire project to fail the average income test. To reduce that risk, the proposed regulations described two possible mitigating actions that a taxpayer could have taken to avoid disqualifying the project. Because the final regulations differ from the proposed regulations in a way that avoids that risk, there is no longer a need for mitigating actions. For this reason, the final regulations do not include rules related to mitigating actions.

C. Recordkeeping and Reporting Requirements

In response to comments on the proposed rule, the final rule provides significant flexibility regarding the qualified group of units used to satisfy the average income set-aside and the qualified group of units used for purposes of computing the applicable fraction. Providing the requested flexibility necessitates that the taxpayer have the discretion and responsibility to make these identifications and that the contemporary identification of the units be unambiguous.

Specifically, to implement the changes made in response to the comments on the proposed rule, §1.42-19(b)(3) of the final regulations provides that a taxpayer separately identifies (i) units in the qualified group of units used for satisfying the average income set-aside and (ii) units in the qualified group for purposes of the applicable fractions. Section 1.42-19T(c)(1) of the temporary regulations requires that this be done by recording these identifications in the taxpayer's 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 by communicating that identification annually to the applicable Agency. These rules promote certainty and administrability. The rules, in conjunction with the other procedures provided in §1.42-19T(c)(3), will allow taxpayers, Agencies, and the IRS to more easily verify the status, including the average imputed income limitation, of the qualified group of units used for purposes of satisfying the average income set-aside and the qualified group of units used for purposes of determining the applicable fraction(s).

In addition, taxpayers are required to report specified information to Agencies and to maintain records in sufficient detail to establish the accuracy of the project's applicable fractions, the satisfaction of the average income set-aside, and compliance with requirements in section 42 and the applicable regulations. Section 1.6001-1 requires the keeping of records "sufficient to establish the amount of gross income, deductions, credits, or other matters required to be shown by such person in any return of such tax or information." *See* §§ 1.6001-1 and 1.42-5.

D. Designation of Imputed Income Limitations and Identification of Units

Section 42(g)(1)(C)(ii) contains substantive requirements for income limitations applicable in the average income test. Specifically, the taxpayer must designate the imputed income limitation for each unit taken into account under the average income test; the average of those imputed income limitations cannot exceed 60 percent of AMGI; and the designated imputed income limitation of any unit must be 20, 30, 40, 50, 60, 70, or 80 percent of AMGI. That statutory provision, however, does not contain procedural requirements to specify the manner in which taxpayers must designate the imputed income limitation of units.

Filling this gap, the proposed regulations added procedural requirements that a taxpayer must designate each imputed income limitation in accordance with: (1) any procedures established by the IRS in forms, instructions, or publications or in other guidance published in the Internal Revenue Bulletin pursuant to §601.601(d)(2)(ii)(*b*); and (2) any procedures established by the Agency that has jurisdiction over the low-income housing project that contains the units to be designated, to the extent that those Agency procedures are consistent with IRS guidance and the governing regulations.

No negative comments were submitted regarding these provisions, but, on review, and in conjunction with other revisions made based on comments received, the Treasury Department and the IRS determined that more detailed designation rules were needed to promote certainty and administrability. Section 1.42-19T(c)(3)(iv) of the temporary regulations provides that 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 final regulations require the initial designation of a unit to be made no later than when a unit is first occupied as a low-income unit. *See* §1.42-19(c)(3)(i). Under §1.42-19T(c)(3)(iv) of the temporary regulations, the designation must also be communicated annually to the applicable Agency, and the applicable Agency may establish the time and manner in which information is provided to it. *See* §1.42-19T(c)(2)(i).

In the context of the final regulations' provision of significant flexibility with respect to satisfying the average income test and identifying a qualified group of units, these designation and identification rules will facilitate taxpayer access to this additional flexibility. Providing a specific method of designation will give taxpayers more certainty than the proposed regulations as to how to meet the statutory requirement of designation. The rule will also benefit administration by ensuring a contemporaneous record of designation, without creating a significant burden on taxpayers. The final regulations also revise timing of the designation so that it is no longer required by the end of the first year of the credit period, and instead is based on when a unit is first occupied as a low-income unit. This rule better aligns the timing of designation with the rental of low-income units and should allow a taxpayer to make designations after having a chance to evaluate the market for a particular unit. Finally, requiring annual communication of the information to the applicable Agency will help the Agency determine whether a project is in compliance with the requirements of section 42. The temporary regulations give flexibility to Agencies to determine the best time and manner for taxpayers to communicate the information so each Agency can ensure the system best serves that particular Agency with minimal burden.

Importantly, the temporary regulations also provide Agencies with the discretion, on a case-by-case basis, to waive in writing any failure to comply with the temporary regulations' recordkeeping and reporting requirements. *See* § 1.42-19T(c)(4). The waiver may be done up to 180 days after discovery of the failure, whether by taxpayer or Agency. At the discretion of the applicable Agency, this waiver may treat the relevant requirements as having been satisfied.

In providing Agencies with the ability to waive and the timeline for waiving, the Treasury Department and the IRS considered comments made in response to the proposed regulations regarding the rules for "removed units" and the timing for completing "mitigating actions." In response to the proposed regulations' rules on removed units, Agencies commented that they do not have authority to determine the tax consequences of noncompliance with respect to the requirements of section 42, and, instead, Agencies are only responsible for determining the existence of noncompliance itself. The ability of Agencies to waive the failure to comply with the procedural requirements provided by the final regulations is not inconsistent with the scope of Agency responsibility, and the IRS itself will ultimately determine the tax consequences of noncompliance.

With respect to timing, many commenters suggested that a 60-day period in which to take mitigating actions beginning on the first day after the year of noncompliance was too short and began before the noncompliance may be known. Commenters recommended various time periods, and also suggested that the time period run from the time of discovery of the noncompliance. Although the Agency waiver rule in the temporary regulations involves a different situation, commenters' recommendations provide valuable information regarding Agencies' need for a sufficient period of time to consider whether to grant the waiver and that this time period should begin when the failure to comply is discovered. Thus, the temporary regulations provide that the period to provide a waiver is the 180-day period after discovery of the failure to comply by taxpayer or Agency.

E. Timing of designation of income limitations

One commenter expressed concern that, in some situations, a multiple-building project claims the section 42 credit beginning in two different years depending on when the different buildings in the project are fully leased, and thus, the credit period for one building in the project may begin in one taxable year and the credit period for a second building in the same project may begin during the subsequent taxable year. In such a situation, the commenter requested, the regulations should permit the taxpayer to make unit designations at the end of the respective taxable years in which the credit period begins for each building in the same project.

The final regulations require a designation of the imputed income limitation for a unit by the time the unit is first occupied as a low-income unit, which could take place in different taxable years for different units. This rule also allows conversion of a market-rate unit to low-income status, with designation of an income limitation occurring any time before it is first occupied as a low-income unit. Thus, the final regulations provide the flexibility that may be needed by multiple-building projects. In addition, as described later, the final regulations permit the changing of a unit's imputed income limitation in certain circumstances. For an unoccupied unit that is subject to a change in imputed income limitation, the final regulations provide that the taxpayer must designate the unit's changed imputed income limitation prior to occupancy of that unit. For an occupied unit that is subject to a change in imputed income limitation, the taxpayer must designate the unit's changed imputed income limitation prior to the end of the taxable year in which the change occurs.

F. Changing a Unit's Imputed Income Designation

1. The proposed regulations on changes to income designations

In general, the proposed regulations did not allow income limitations to be changed after they had been designated.

The preamble to the proposed regulations, however, requested comments on an alternative mitigating approach for situations in which a unit losing status as a low-income unit had caused the average of unit limitations to rise above 60 percent of AMGI as of the close of a taxable year. The mitigating approach would have allowed the taxpayer to redesignate the imputed income limitation of a low-income unit to return the average of unit limitations to 60 percent of AMGI or lower.

2. Comments seeking ability to change designations

Numerous commenters disagreed with the proposed regulations' disallowance of modifying the designated imputed income limitation of a unit. In general, these commenters stressed that greater flexibility to change unit designations would align with what multiple Agencies had been pursuing to implement existing State and local policies. Some commentators observed that the proposed regulations may conflict with other Federal or State laws or programs that, in certain cases, require rental housing to accommodate a tenant's need to move to another unit. Additionally, some commentators noted that after enactment of section 42(g)(1)(C), some Agencies adopted their own guidance with which the subsequently published proposed regulations were in conflict.

Multiple commenters recommended that the final regulations allow taxpayers to modify unit designations if the Agency with jurisdiction over the project at issue allows for that in its policies and the Agency consents to the change. A different commenter suggested that the final regulations should allow taxpayers to adjust imputed income limitation designations over time, provided that the taxpayer's adjusted designations continue to satisfy the requirements of the average income test (that is, at all times 40 percent of the units remain rent-restricted and occupied by tenants whose income does not exceed the imputed income limitation designated by the owner, and the average of the imputed income limitation designations does not exceed 60 percent of AMGI in any given year).

3. Final regulations on changing designations of income limitations

The Treasury Department and the IRS agree with taxpayers that the final regulations should allow greater flexibility in changes in unit designations than the proposed regulations did. Because not all Agencies may want the exact same standards for permitting redesignations, the final regulations address these taxpayer concerns by providing Agencies significant flexibility in determining procedures.

Under the final regulations, a taxpayer may change the imputed income limitation designation of a previously designated low-income unit in any of the following circumstances:

(1) In accordance with any procedures established by the IRS in forms, instructions, or guidance published in the Internal Revenue Bulletin pursuant to §601.601(d)(2)(ii)(*b*) of this chapter.

(2) In accordance with an Agency's publicly available written procedures, if those procedures are available to all of the Agency's projects that have elected the average income test.

(3) To enhance protections set forth in the Americans With Disabilities Act of 1990 (ADA), Pub. L. 101-336, 104 Stat. 328; the Fair Housing Amendments Act of 1988, Pub. L. 100-430, 102 Stat.1619; the Violence Against Women Act of 1994, Pub. L. 103-322, 108 Stat. 1902; the Rehabilitation Act of 1973, Pub. L. 93-112, 87 Stat. 394; or any other State, Federal, or local law or program that protects tenants and that is identified by the IRS or an Agency in a manner described in (1) or (2) above. The tenant protections that apply to an average-income project and that redesignation may enhance do not necessarily have any specific connection to section 42. For example, the protections may be

ones that apply to all multifamily rental housing, or they may apply to the project at issue because some congressionally authorized spending supported the project with Federal financial assistance. Even if a tenant protection does not legally apply to a particular average-income project but does apply to analogous multifamily rental housing, the owner of the project may redesignate income limitations to implement the protection for the project's residents.

(4) To enable a current income-qualified tenant to move to a different unit within a project keeping the same income limitation (and thus the same maximum gross rent), with the newly occupied unit and the vacated unit exchanging income limitations.

(5) To restore the required average income limitation for purposes of identifying a qualified group of units either for purposes of satisfying the average income set-aside or for purposes of identifying the units to be used in computing applicable fraction(s). This rule is limited to newly designated, or redesignated, units that are vacant or are occupied by a tenant that would satisfy the new, lower imputed income limitation.

Also, the temporary regulations provide that a 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). *See* §1.42-19T(d)(2). The new designation must also be communicated to the applicable Agency in the time and manner required by the applicable Agency and must become part of the annual report to the Agency of income designations. As part of its discretion to specify the manner of communicating the new designation, the Agency may, if it wishes, require identification of the justification for the redesignation. The prior designation must be retained in the books and records for the period specified in §1.42-19T(c)(3)(iv). These requirements for redesignations are consistent with those for initial designation of a unit's imputed income limitation and, similarly, are intended to increase both certainty and administrability with respect to redesignations.

G. Applicability Dates

Three commenters recommended that the final regulations should provide relief for projects that have elected the average income minimum set-aside prior to the publication of the final rule. These commenters suggested that taxpayers that elected the average income test before the finalization of the regulations did so based on a set of expectations that may be in conflict with how the final regulations actually work. For example, one commenter stated that the final regulations should provide taxpayers the opportunity to choose a different minimum set-aside.

Section 42 provides that an election of a minimum set-aside is irrevocable. Therefore, these final regulations do not permit taxpayers to change a minimum set-aside election.

In general, the final regulations apply to taxable years beginning after December 31, 2022. Section 1.42-19(f)(2) provides rules for residential units in projects that were already occupied prior to the applicability date of the regulations. The final regulations in both §§1.42-15(i)(2) and 1.42-19(f)(3) also contain provisions that make them more broadly available for taxpayers that desire their application. For taxable years prior to the first taxable year to which these regulations apply, taxpayers may rely on a reasonable interpretation of the statute in implementing the average income test for taxable years to which these regulations do not apply.

H. Good Cause

For the reasons discussed above, the Treasury Department and the IRS consider the recordkeeping and reporting requirements contained in the temporary regulations to be a logical outgrowth of the proposed rule. In any event, the Treasury Department and the IRS determine that there would be good cause to issue the temporary regulations contained in this Treasury Decision without additional notice and the opportunity for public comment. This action may be taken pursuant to section 553(b)(3)(B) of the Administrative Procedure Act, which provides that advance notice and the opportunity for public comment are not required with respect to a rulemaking when an "agency for good cause finds (and incorporates the finding and a brief statement of reasons therefor in the rules issued) that notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest." Under the "public interest" prong of 5 U.S.C. 553(b)(3)(B), the good cause exception appropriately applies where notice-and-comment would harm, defeat, or frustrate the public interest, rather than serving it.

It would frustrate the public interest to delay the applicability date of the regulations until the recordkeeping and reporting requirements have received additional notice and comment. Taxpayers are seeking to rely on the substantive final regulations as soon as possible, and taxpayers cannot do so prior to the applicability date of the requirements in the temporary regulations. In general, these substantive final regulations provide significant flexibility with respect to satisfying the average income test, identifying a qualified group of units for use in the average income set-aside test and applicable fraction determinations, and changing the imputed income limitation designations of residential units. This increased flexibility was in response to taxpayer comments on the proposed regulations, including taxpayer complaints about burdens in the proposed regulations. The increased regulatory flexibility, in turn, necessitates these recordkeeping and reporting requirements to enhance administrability and certainty for the taxpayers and Agencies that will be taking advantage of the flexibility. In addition, these requirements are minimally burdensome. The recordkeeping requirements are similar to existing recordkeeping requirements for low-income housing projects, and Agencies may specify the time and manner of communication of regulatorily required information and may waive any failure to comply.

There is also good cause to find notice is "unnecessary" within the meaning of 5 U.S.C. 553(b)(3)(B). The Treasury Department and the IRS are responding to commenters by providing the flexibility they sought, which requires enhanced tracking to prevent abuse. The recordkeeping additions do not alter the substance of the basic rule provisions, which are a logical outgrowth of the NPRM. And because the recordkeeping requirements provide what is minimally necessary to ensure compliance and oversight, soliciting further comment would not alter these minimal recordkeeping requirements.

Accordingly, the Treasury Department and the IRS have determined that notice is unnecessary and that it is in the public interest to allow expedited reliance on the recordkeeping and reporting requirements contained in the temporary regulations. At the same time, as set forth above, the Treasury Department and the IRS are soliciting comments on the recordkeeping and reporting requirements in the notice of proposed rulemaking published contemporaneously with this final rule. At the time of publication, the Office of Management and Budget (OMB) has considered and approved these recordkeeping and reporting requirements under the Paperwork Reduction Act so that taxpayers can rapidly access the flexibility provided in these final regulations regarding the average income test.

Special Analyses

Regulatory Planning and Review – Economic Analysis

Executive Orders 12866 and 13563 direct agencies to assess costs and benefits of available regulatory alternatives and, if regulation is necessary, to select regulatory approaches that maximize net benefits (including potential economic, environmental, public health and safety effects, distributive impacts, and equity). Executive Order 13563 emphasizes the importance of quantifying both costs and benefits, of reducing costs, of harmonizing rules, and of promoting flexibility.

These final regulations have been designated as subject to review under Executive Order 12866 pursuant to the Memorandum of Agreement (April 11, 2018) (MOA) between the Treasury Department and the Office of Management and Budget (OMB) regarding review of tax regulations. The Office of Information and Regulatory Affairs has designated these final regulations as significant under section 1(b) of the MOA.

A. Background

The Tax Reform Act of 1986, Pub. L. 99-514, 100 Stat. 2085, created the low-income housing credit under section 42 of the Code. Section 42(a) provides that the credit amount earned by a qualified low-income building depends on the number of low-income units in the building, among other factors. Among other requirements, a low-income unit as defined in section 42(i)(3) must be rent-restricted, and the individuals occupying the unit must meet the income limitation applicable to the project of which the building is a part.

To qualify as a low-income housing project, one of the section 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. 115-141, 132 Stat. 348 (2018 Act), section 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 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. To be rent restricted, a unit must have maximum gross rent no more than 30 percent of the unit's income limitation.

The 2018 Act added section 42(g)(1)(C), which contains a third minimum set-aside test—the average income test. A project meets the minimum requirements of the average income test if 40 percent or more 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 specific unit. (In the case of a project described in section 142(d)(6), 40 percent in the preceding sentence is replaced by 25 percent.) For a project to meet the average income test, among other criteria, the average of the imputed income limitations must not exceed 60 percent of AMGI.

B. Baseline

The Treasury Department and the IRS have assessed the benefits and costs of these final regulations relative to a no-action baseline reflecting anticipated Federal income tax-related behavior in the absence of these regulations.

C. Economic Analysis

These final regulations provide guidance on the average income test under section 42(g)(1)(C). Despite the absence of this guidance, between 2018 and 2022 approximately 200 taxpayers elected the average income test for projects containing, in the aggregate, just over 2,000 buildings. With the benefit of this guidance, we project that an additional 100 taxpayers will elect the average income test annually, for around 1,000 buildings in aggregate, relative to a baseline scenario of no guidance.

These final regulations are expected to increase election of the average income test because the regulations will reduce uncertainty regarding the interpretation of 42(g)(1)(C). Absent these regulations, some taxpayers might shy away from the average income test, fearing adverse tax consequences if their interpretation of the statute is determined to be incorrect as well as lost time and expense for litigation, even if their interpretation is eventually confirmed. Instead, these or other taxpayers would elect either the 20-50 test or the 40-60 test.

Projects electing the average income test may be more financially stable and more likely to be mixed income than if they had to rely on the 20-50 or 40-60 tests; however, in aggregate, the final regulations are expected to have essentially no immediate effect on the number of affordable housing units produced. The pool of potential low-income housing credits allocated by state housing agencies is capped annually and is generally oversubscribed. Thus any increase in allocated credits flowing to projects electing the average income test is expected to be offset by a concomitant reduction in credits flowing to projects electing one of the other two set-aside tests.

Despite having no measurable impact on the stock of affordable housing, these final regulations will likely have some economic effect. First, there will likely be a minor efficiency gain to taxpayers electing the average income set-aside compared to the situation of taxpayers that, in the absence of this guidance, would experience uncertainty interpreting section 42(g)(1)(C). These taxpayers may save on consulting fees or hours of effort. Second, there may be a minor efficiency gain from avoiding time spent in litigation regarding the interpretation of section 42(g)(1)(C). These are unambiguous benefits of providing the final regulations, even if quantitatively small. Third, there may be costs associated with the record-keeping requirements of these final regulations. In Section II of these Special Analyses, we estimate that the annual paperwork burden for this regulation is $676,712 in aggregate. These costs fall upon low-income housing tax credit (LIHTC) building owners who choose to incur them when electing the average income test.

Less directly, the final regulations will likely result in a marginal geographic redistribution in the location of LIHTC-supported housing, away from densely populated areas and towards more sparsely populated ones. Absent an option to elect the average income test, property owners seeking LIHTCs must rely on either the 20-50 or 40-60 tests. These tests set a single income standard for all LIHTC-generating units in a building. For a building to be financially feasible, its owners must be confident that there is a sufficiently large pool of potential renters having incomes in these relatively narrow ranges (just under 50 or 60 percent of AMGI). These conditions are more easily met in densely populated areas.

In contrast, with income averaging, developers have leeway to establish a variety of income limitations in a building. Thus, in a sparsely populated area where there are not enough people in the relatively narrow required range of incomes to support a 20–50 or 40–60 building, an average income building may be financially feasible. Despite the low population density, the wider range of potential tenant incomes may enable the building owner to fill the low-income units with qualifying tenants from that vicinity. That ability could make the difference in whether or not the project is feasible.

To be sure, most of the effect of the average income test on the geographic distribution of affordable housing is a direct consequence of statutory amendments to section 42 made by the 2018 Act, independent of this regulatory guidance. However, to the extent that the final regulations encourage some taxpayers to use the average income test who otherwise would not, the regulations reinforce the statutory effect. The end result is a marginal transfer of economic well-being from renters and LIHTC property developers in densely populated areas towards renters and LIHTC property developers in sparsely populated areas.

II. Paperwork Reduction Act

The Paperwork Reduction Act of 1995 (44 U.S.C. 3501-3520) (PRA) requires that a Federal agency obtain the approval of OMB before collecting information from the public, whether such collection of information is mandatory, voluntary, or required to obtain or retain a benefit. The collections of information contained in these regulations has been approved by OMB under control number 1545-0988.

The collections of information that are needed for certainty and administrability of the final regulations are included in §1.42-19T of the temporary regulations. Section 1.42-19T(c)(1) provides recordkeeping and reporting requirements related to the identification of a qualified group of units for each of (i) satisfaction of the average income set-aside test and (ii) applicable fraction determinations. Section 1.42-19T(c)(2) provides reporting requirements to the Agency with jurisdiction over a project. Section 1.42-19T(c)(3)(iv) provides recordkeeping and reporting requirements related to designations of the imputed income limitations for residential units. Section 1.42-19T(d)(2) provides recordkeeping and reporting requirements related to changing a unit's designated imputed income limitation.

This information in the collections of information will generally be used by the IRS and Agencies for tax compliance purposes and by taxpayers to facilitate proper reporting and compliance. Specifically, the collections of information in §1.42-19T apply to taxpayer owners of projects that receive the low-income housing credit and elect the average income set-aside. With respect to the recordkeeping requirements in §1.42-19T(c)(3)(iv) and (d)(2) and section 42(g)(1)(C)(ii)(I) requires that the taxpayer designate the imputed income limitations of the units taken into account for purposes of the average income test. Thus, the recordkeeping requirements that are provided allow for a process of designation that will result in a reliable record of both the original designations of the imputed income limitations of low-income units and any redesignations of units' limitations within a project.

The recordkeeping rules in §1.42-19T(c)(1) with respect to a qualified group of units are similarly needed to ensure there is a reliable record to show that the units used for purposes of the average income set-aside test, and for determining a building's applicable fraction were part of a group of units within the project whose average designated imputed income limitations do not exceed 60 percent of AMGI. This limitation is consistent with the requirement in section 42(g)(1)(C)(ii)(II). The annual reporting requirements in §1.42-19T(c)(1) and (3) and (d)(2) are also similar in substance to other annual certifications required of taxpayers. For example, minimum certifications by taxpayers are required in qualified allocation plans as provided in §1.42-5(c). The reporting requirements in these final regulations also provide added flexibility by allowing the applicable Agency to determine the time and manner that the reporting is made under §1.42-19T(c)(2)(i). Also, §1.42-19T(c)(4) gives Agencies the ability to waive any failure of reporting on a case-by-case basis.

A summary of paperwork burden estimates follows:

Estimated number of respondents: Approximately 200 taxpayers elected the average income test for just over 2,000 buildings between 2018 and 2022. When viewed annually, we project that approximately 100 additional taxpayers will have eligible buildings and 1,000 additional buildings will be eligible under the average income test.

Estimated burden per response: We estimate that identifying which units are for use in the average income set-aside test and applicable fraction determinations and designating a unit's imputed income limitation takes an average of 15 minutes per unit. Based on an estimated average of 15 units per building and an average 15 minutes of time per unit, an impacted taxpayer will incur an average of 225 minutes per building to record the additional designations due to the flexibility under the regulations for the average income test. Total average annual burden for recording the designations per building is 11,250 hours (15 units x 15 minutes x 3,000 buildings).

Taxpayers are also required to report redesignation of units, and why they are required to redesignate units during the year. For purposes of this analysis, we assume that an average of 4 units per building will be redesignated annually. We estimate each redesignation will take an average of 10 minutes. Thus, we estimate the average number of minutes per year to record redesignations for an impacted taxpayer to be 40 minutes per building for a total average annual burden of 2,000 hours (40 minutes x 3,000 buildings).

In addition, we estimate an annual reporting burden related to the expanded flexibility rules to average 20 minutes per impacted taxpayer for a total burden of 100 hours (20 minutes x 300 taxpayers).

Estimated frequency of response: Annual.

Estimated total burden hours: The annual burden hours for this regulation is estimated to be 13,350 hours. Using a monetization rate of $50.69 per hour (2020 dollars), the burden for this regulation is $676,712 for impacted taxpayers.

A Federal agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid control number.

III. Regulatory Flexibility Act

Pursuant to the Regulatory Flexibility Act (RFA) (5 U.S.C. chapter 6), it is hereby certified that this final regulation will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that, prior to the publication of this final regulation and before the enactment of the 2018 Act, taxpayers were already required to satisfy either the 20-50 test or the 40-60 test, as elected by the taxpayer, in order to qualify as a low-income housing project. The 2018 Act added a third minimum set-aside test (the average income test) that taxpayers may elect. This final regulation sets forth requirements for the average income test, and the costs associated with the average income test are similar to the costs associated with the 20-50 test and 40-60 test. In addition, affected taxpayers, including some who end up not electing the average income test will incur minimal costs in reading and understanding the regulations. The Treasury Department and the IRS estimate that the burden involved in reading and understanding the regulations will be approximately 3 to 5 hours and largely will be borne by advisors and trade media. A portion of the cost to such advisors and trade media will be passed on to taxpayers.

As described in more detail in the Paperwork Reduction Act section of this preamble, approximately 200 taxpayers elected the average income test between 2018 and 2022. When that figure is viewed annually, the Treasury Department and the IRS project that approximately 100 additional taxpayers will elect the average income test due to the final regulations. For the 300 taxpayers affected, the annual burden hours for this regulation is estimated in the Paperwork Reduction Act analysis to be 13,350 hours. Thus, the average annual burden hours amount to 44.5 hours per affected small entity. This estimate reflects all recordkeeping and reporting requirements associated with the final regulations, including (i) identifying which units are for use in the average income set-aside test, (ii) identifying which units are for use in applicable fraction determinations, (iii) designating a unit's imputed income limitation, (iv) reporting redesignation of units, (v) reporting reasons why units are redesignated, and (vi) the reporting burden related to the expanded flexibility rules.

Monetized at $50.69 per hour (2020 dollars), the average annual burden hours represent a cost of $2,256 per affected small entity. This amount is likely quite small relative to the entity's revenue. A precise estimate of typical revenue is not possible with the data available to the Treasury Department and the IRS. However, the Treasury Department and the IRS estimate that the typical annual LIHTC allocation to an affected entity is between $125,000 and $1,450,000. Relative to these sums, the $2,256 annual cost of the regulations is not a significant economic impact.

Accordingly, it is hereby certified that these regulations will not have a significant economic impact on a substantial number of small entities within the meaning of section 601(6) of the RFA.

For the applicability of the RFA to the temporary regulations, refer to the Special Analyses section of the preamble to the notice of proposed rulemaking published in the Proposed Rules section in this issue of the **Federal Register**.

IV. Section 7805(f)

Pursuant to section 7805(f), the proposed regulation was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business, and no comments were received. The Treasury Department and the IRS also requested comments from the public.

V. Unfunded Mandates Reform Act

Section 202 of the Unfunded Mandates Reform Act of 1995 (UMRA) requires that agencies assess anticipated costs and benefits and take certain other actions before issuing a final rule that includes any Federal mandate that may result in expenditures in any one year by a State, local, or tribal government, in the aggregate, or by the private sector, of $100 million in 1995 dollars, updated annually for inflation. This final rule does not include any Federal mandate that may result in expenditures by State, local, or tribal governments, or by the private sector in excess of that threshold.

VI. Executive Order 13132: Federalism

Executive Order 13132 (Federalism) prohibits an agency from publishing any rule that has federalism implications if the rule either imposes substantial, direct compliance costs on State and local governments, and is not required by statute, or preempts State law, unless the agency meets the consultation and funding requirements of section 6 of the Executive order. These regulations do not have federalism implications and do not impose substantial direct compliance costs on State and local governments or preempt State law within the meaning of the Executive order.

VII. Congressional Review Act

Pursuant to the Congressional Review Act (5 U.S.C. 801 et seq.), the Office of Information and Regulatory Affairs designated this rule as not a "major rule," as defined by 5 U.S.C 804(2).

Drafting Information

The principal authors of these regulations are Dillon Taylor, Office of the Associate Chief Counsel (Passthroughs and Special Industries), and Michael J. Torruella Costa, formerly at Office of the Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the Treasury Department and the IRS participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1--INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding in numerical order entries for §§ 1.42-19 and 1.42-19T to read, in part, as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.42-15 also issued under 26 U.S.C. 42(n);

* * * * *

Section 1.42-19 also issued under 26 U.S.C. 42(n);

Section 1.42-19T also issued under 26 U.S.C. 42(n);

* * * * *

Par. 2. Section 1.42-0 is amended by:

1. In the introductory text, removing "1.42-18" and adding "1.42-19" in its place.

2. In §1.42-15:

i. Revising paragraph (c).

ii. Adding paragraphs (c)(1) and (2) and (c)(2)(i) through (iv).

iii. Revising paragraph (i).

iv. Adding paragraphs (i)(1) and (2).

3. Adding a heading and entries for §1.42-19.

The additions and revisions read as follows:

§1.42-0 Table of contents.

* * * * *

§1.42-15 Available unit rule.

* * * * *

Par. 3. Section 1.42-15 is amended by:

1. Revising the definition of *Over-income unit* in paragraph (a).

2. In paragraph (c):

i. Revising the heading.

ii. Designating the text as paragraph (c)(1) and adding a heading for newly designated paragraph (c)(1).

3. Adding paragraph (c)(2).

4. In paragraph (i):

i. Revising the heading.

ii. Designating the text as paragraph (i)(1).

5. In newly designated paragraph (i)(1):

i. Adding a heading.

ii. Removing "This section" and adding "Except for paragraph (c)(2) of this section, this section" in its place.

6. Adding paragraph (i)(2).

The revisions and additions read as follows:

§1.42-15 Available unit rule.

(a) * * *

Over-income unit means, in the case of a project with respect to which the taxpayer elects the requirements of section 42(g)(1)(A) or (B) (that is, the 20–50 or 40–60 tests), a low-income unit in which the aggregate income of the occupants of the unit increases above 140 percent of the applicable income limitation under section 42(g)(1)(A) and (B), or above 170 percent of the applicable income limitation for deep rent skewed projects described in section 142(d)(4)(B). In the case of a project with respect to which the taxpayer elects the requirements of section 42(g)(1)(C) (that is, the average income test), *over-income unit* means a residential unit described in §1.42-19(b)(1)(i) through (iii) in which the aggregate income of the occupants of the unit increases above 140 percent (170 percent in case of deep rent skewed projects described in section 142(d)(4)(B)) of the greater of 60 percent of area median gross income or the imputed income limitation designated with respect to the unit under §1.42-19(b).

* * * * *

(c) *Exceptions*—(1) *In general*. * * *

(2) *Rental of next available unit in case of the average income test*—(i) *Basic rule*. In the case of a project with respect to which the taxpayer elects the average income test, if a unit becomes an over-income unit within the meaning of paragraph (a) of this section, that unit ceases to be described in §1.42-19(b)(1)(ii) if—

(A) Any residential rental unit (of a size comparable to, or smaller than, the over-income unit) is available, or subsequently becomes available, in the same low-income building; and

(B) That available unit is occupied by a new resident whose income exceeds the limitation described in paragraph (c)(2)(iv) of this section.

(ii) *No requirement to comply with the next available unit rule in a specific order*. Where multiple units in a building are over-income units at the same time—

(A) The order in which available units are occupied makes no difference for purposes of complying with the rules in this section (next available unit rule); and

(B) In making imputed income limitation designations, the taxpayer must take into account the limitations described in paragraphs (c)(2)(iii) and (iv) of this section.

(iii) *Deep rent skewed projects*. In the case of a project described in section 142(d)(4)(B) with respect to which the taxpayer elects the average income test, if a unit becomes an over-income unit within the meaning of paragraph (a) of this section, that unit ceases to be a unit described in §1.42-19(b)(1)(ii) if—

(A) Any residential unit described in §1.42-19(b)(1)(i) through (iii) is available, or subsequently becomes available, in the same low-income building; and

(B) That unit is occupied by a new resident whose income exceeds the lesser of 40 percent of area median gross income or the imputed income limitation designated with respect to that unit.

(iv) *Limitation*. The limitation described in this paragraph (c)(2)(iv) is—

(A) In the case of a unit that was described in §1.42-19(b)(1)(i) through (iii) prior to becoming vacant, the imputed income limitation designated with respect to the available unit for the average income test under §1.42-19(b); and

(B) In the case of any other unit, the highest imputed income limitation that could be designated (consistent with section 42(g)(1)(C)(ii)(III)) for that available unit under §1.42-19(c) such that the average of all imputed income designations of residential units in the project does not exceed 60 percent of area median gross income (AMGI).

(v) *Example*. The operation of paragraph (c)(2) of this section (that is, the next available unit rule for the average income test) is illustrated by the following example.

(A) *Facts*. (*1*) A single-building housing project received an allocation of housing credit dollar amount for 10 low-income units. The taxpayer who owns the project constructs the building with 10 identically sized units and elects the average income test. In the first year, the taxpayer intended to have 8 units that will qualify as low-income units (within the meaning of §1.42-19(b)(1)), and 2 units that are market-rate units. The taxpayer properly and timely designates the imputed income limitations for the 8 units as follows: 4 units at 80 percent of AMGI; and 4 units at 40 percent of AMGI.

Table 1 to Paragraph (c)(2)(v)(A)(*1*)

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	Market Rate
6	40 percent of AMGI
7	40 percent of AMGI
8	40 percent of AMGI
9	40 percent of AMGI
10	Market Rate

(*2*) In the first taxable year of the credit period (Year 1), the project is fully leased and occupied by income-qualified residents in Units ##1-4 and 6-9. In Year 2, Unit #1 and Unit #6 become over-income. The tenant residing in Unit #5 vacated that unit. Taxpayer then designated an imputed income limitation of 40 percent of AMGI for Unit #5. Later in Year 2, the tenant residing in Unit #10 vacated that unit. Taxpayer designated an imputed income limitation of 80 percent of AMGI for Unit #10. After those designations, Unit #10 was occupied by a new income-qualified tenant, and then later, Unit #5 was occupied by a new income-qualified resident.

(B) *Analysis*. Taxpayer sought to maintain the status of the over-income units (Unit #1 and Unit #6) as units described in §1.42-19(b)(1)(ii). As the then-market rate units (Units ##5 and 10) became available to rent, Taxpayer designated imputed income limitations for them at 40 percent and 80 percent of AMGI, respectively. Immediately after each designation, the average of the designations in the project does not exceed 60 percent AMGI. Pursuant to the rule in paragraph (c)(2)(ii) of this section, when there are multiple over-income units, Taxpayer is not required to rent the next-available units in a specific order, even though they may have different imputed income limitations. Thus, Taxpayer complied with the rules of the next available unit rule, and Unit #1 and Unit #6 maintain status as units described in §1.42-19(b)(1)(ii).

* * * * *

(i) *Applicability dates*—(1) *In general*. * * *

(2) *Applicability dates under the average income test*. The requirements of the second sentence of the definition of *over-income unit* in paragraph (a) of this section and paragraph (c)(2) of this section apply to taxable years beginning after December 31, 2022. A taxpayer may choose to apply this section to a taxable year beginning after October 12, 2022, and before January 1, 2023, provided that the taxpayer chooses to apply §1.42-19 to the same taxable year.

Par. 4. Section 1.42-19 is added to read as follows:

§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.

(ii) *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.

(iii) *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 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 October 12, 2022, 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 October 12, 2022, 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.

Paul J. Mamo,
Assistant Deputy Commissioner for Services and Enforcement.

Approved: September 30, 2022.

Lily L. Batchelder,
Assistant Secretary (Tax Policy).

(Filed by the Office of the Federal Register on October 7, 2022, 11:15 a.m., and published in the issue of the Federal Register for October 12, 2022, 87 F.R. 61489)

Part IV

Notice of Proposed Rulemaking

Section 42, Low-Income Housing Credit Average Income Test Regulations

REG-113068-22

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations concerning recordkeeping and reporting requirements for the average income test for purposes of the low-income housing credit. If a building is part of a residential rental project that satisfies this test, the building may be eligible to earn low-income housing credits. These proposed regulations affect owners of low-income housing projects and State or local housing credit agencies that monitor compliance with the requirements for low-income housing credits. In the Rules and Regulations section of this issue of the **Federal Register**, the IRS is issuing temporary regulations concerning the recordkeeping and reporting requirements for the average income test. The text of the temporary regulations also serves as the text of these proposed regulations.

DATES: Written (including electronic) comments must be received by December 12, 2022.

ADDRESSES: Commenters are strongly encouraged to submit public comments electronically. Submit electronic submissions via the Federal eRulemaking Portal at www.regulations.gov (indicate IRS and REG-113068-22) by following the online instructions for submitting comments. Once submitted to the Federal eRulemaking Portal, comments cannot be edited or withdrawn. The Department of the Treasury (Treasury Department) and the IRS will publish for public availability any comment submitted electronically, and on paper, to its public docket.

FOR FURTHER INFORMATION CONTACT: Concerning these proposed regulations, Dillon Taylor at (202) 317-4137; concerning submissions of comments, Regina L. Johnson at (202) 317-6901 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background and Explanation of Provisions

Temporary regulations in the Rules and Regulations section of this issue of the **Federal Register** add §1.42-19T to the temporary Income Tax Regulations (26 CFR part 1) that relate to the average income test under section 42 of the Internal Revenue Code. These new temporary regulations set forth certain recordkeeping and reporting requirements that relate to the rules in §1.42-19. The text of the temporary regulations also serves as the text of these proposed regulations. The preamble to the temporary regulations explains the amendments. These proposed regulations would integrate the text of the temporary regulations into portions of §1.42-19 that are currently reserved.

Special Analyses

These proposed regulations are not subject to review under section 6(b) of Executive Order 12866 pursuant to the Memorandum of Agreement (April 11, 2018) between the Department of the Treasury and the Office of Management and Budget regarding review of tax regulations.

Pursuant to the Regulatory Flexibility Act (5 U.S.C. chapter 6), it is hereby certified that these proposed regulations will not have a significant economic impact on a substantial number of small entities. The basis for this certification can be found in the Special Analyses section of the temporary regulations.

Pursuant to section 7805(f) of the Internal Revenue Code, these proposed regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Comments and a Request for Public Hearing

Before these proposed amendments to the regulations are adopted as final regulations, consideration will be given to comments that are submitted timely to the IRS as prescribed in the preamble under the **ADDRESSES** section. The Treasury Department and the IRS request comments on all aspects of the proposed regulations. Any electronic comments submitted, and any paper comments submitted, will be made available at www.regulations.gov or upon request.

A public hearing will be scheduled if requested in writing by any person who timely submits electronic or written comments. Requests for a public hearing are also encouraged to be made electronically. If a public hearing is scheduled, notice of the date and time for the public hearing will be published in the Federal Register. Announcement 2020-4, 2020-17 IRB 1, provides that until further notice, public hearings conducted by the IRS will be held telephonically. Any telephonic hearing will be made accessible to people with disabilities.

Drafting Information

The principal author of these proposed regulations is Dillon Taylor, Office of Associate Chief Counsel (Passthroughs and Special Industries), IRS. However, other personnel from the IRS and Treasury Department participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

Accordingly, the Treasury Department and the IRS propose to amend 26 CFR part 1 as follows:

PART 1--INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read, in part, as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.42-19 also issued under 26 U.S.C. 42(n);

* * * * *

Par. 2. Section 1.42-19 is amended by adding paragraphs (c)(1) and (2), (c)(3)(iv), (c)(4), and (d)(2) and revising paragraph (f) to read as follows:

§ 1.42-19 Average income test.

*****

(c) * * *

(1) [The text of proposed §1.42-19(c)(1) is the same as the text of §1.42-19T(c)(1) in the final and temporary rule published elsewhere in this issue of the **Federal Register**].

(2) [The text of proposed §1.42-19(c)(2) is the same as the text of §1.42-19T(c)(2) in the final and temporary rule published elsewhere in this issue of the **Federal Register**].

(3) ***

(iv) [The text of proposed §1.42-19(c)(3)(iv) is the same as the text of §1.42-19T(c)(3)(iv) in the final and temporary rule published elsewhere in this issue of the **Federal Register**].

(4) [The text of proposed §1.42-19(c)(4) is the same as the text of §1.42-19T(c)(4) in the final and temporary rule published elsewhere in this issue of the **Federal Register**].

(d) ***

(2) [The text of proposed §1.42-19(d)(2) is the same as the text of §1.42-19T(d)(2) in the final and temporary rule published elsewhere in this issue of the **Federal Register**].

*****

(f) [The text of proposed §1.42-19(f) is the same as the text of §1.42-19T(f) in the final and temporary rule published elsewhere in this issue of the **Federal Register**].

Douglas W. O'Donnell,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on October 7, 2022, 11:15 a.m., and published in the issue of the Federal Register for October 12, 2022, 87 F.R. 61543)

Definition of Terms

Revenue rulings and revenue procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified*, below).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in laws or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in a new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1986 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified* and *superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case, the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A—Individual.
Acq.—Acquiescence.
B—Individual.
BE—Beneficiary.
BK—Bank.
B.T.A.—Board of Tax Appeals.
C—Individual.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
CI—City.
COOP—Cooperative.
Ct.D.—Court Decision.
CY—County.
D—Decedent.
DC—Dummy Corporation.
DE—Donee.
Del. Order—Delegation Order.
DISC—Domestic International Sales Corporation.
DR—Donor.
E—Estate.
EE—Employee.
E.O.—Executive Order.
ER—Employer.
ERISA—Employee Retirement Income Security Act.
EX—Executor.
F—Fiduciary.
FC—Foreign Country.
FICA—Federal Insurance Contributions Act.
FISC—Foreign International Sales Company.
FPH—Foreign Personal Holding Company.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
FX—Foreign corporation.
G.C.M.—Chief Counsel's Memorandum.
GE—Grantee.
GP—General Partner.
GR—Grantor.
IC—Insurance Company.
I.R.B.—Internal Revenue Bulletin.
LE—Lessee.
LP—Limited Partner.
LR—Lessor.
M—Minor.
Nonacq.—Nonacquiescence.
O—Organization.
P—Parent Corporation.
PHC—Personal Holding Company.
PO—Possession of the U.S.
PR—Partner.
PRS—Partnership.
PTE—Prohibited Transaction Exemption.
Pub. L.—Public Law.
REIT—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
S—Subsidiary.
S.P.R.—Statement of Procedural Rules.
Stat.—Statutes at Large.
T—Target Corporation.
T.C.—Tax Court.
T.D.—Treasury Decision.
TFE—Transferee.
TFR—Transferor.
T.I.R.—Technical Information Release.
TP—Taxpayer.
TR—Trust.
TT—Trustee.
U.S.C.—United States Code.
X—Corporation.
Y—Corporation.
Z—Corporation.

Numerical Finding List[1]

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Announcements:

Notices:

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Revenue Procedures:—(Continued)

Revenue Rulings:

Treasury Decisions:

[1] A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2021–27 through 2021–52 is in Internal Revenue Bulletin 2021–52, dated December 27, 2021.

Finding List of Current Actions on Previously Published Items[1]

Bulletin 2022–44

[1] A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2021–27 through 2021–52 is in Internal Revenue Bulletin 2021–52, dated December 27, 2021.

Internal Revenue Service
Washington, DC 20224

INTERNAL REVENUE BULLETIN

The Introduction at the beginning of this issue describes the purpose and content of this publication. The weekly Internal Revenue Bulletins are available at *www.irs.gov/irb/*.

We Welcome Comments About the Internal Revenue Bulletin

If you have comments concerning the format or production of the Internal Revenue Bulletin or suggestions for improving it, we would be pleased to hear from you. You can email us your suggestions or comments through the IRS Internet Home Page *www.irs.gov*) or write to the Internal Revenue Service, Publishing Division, IRB Publishing Program Desk, 1111 Constitution Ave. NW, IR-6230 Washington, DC 20224.