

Chapter 4
Category 11a
Household Income Above
Income Limit upon Initial Occupancy

Definition

This category is used to report units that have been rented to households with incomes that do not meet income eligibility restrictions. According to IRC §42(g)(1), an owner of a tax credit property must elect to serve tenant populations with gross incomes that are either 50% or less of Area Median Gross Income (AMGI) or the National Nonmetropolitan Median Gross Income (NNMGI) when applicable,¹ or 60% or less of AMGI or NNMGI when applicable, as adjusted for family size.² *The National Nonmetropolitan Median Gross Income (NNMGI) is applicable if:

1. IRC §1400N(c)(4), Special Rule for Applying Income Tests, is applicable. The LIHC project was (1) placed in service during 2006, 2007, or 2008, (2) is located in the Gulf Opportunity Zone, and (3) in a nonmetropolitan area (as defined in IRC §42(d)(5)(C)(iv)(IV)).
2. IRC §42(i)(8) is applicable.³ The LIHC project is located in a rural area (as defined in section 520 of the Housing Act of 1949) and the NNMGI is greater than the AMGI. IRC §42(i)(8) is not applicable if the LIHC buildings are financed with tax-exempt bonds.*

Under the terms of an extended use agreement, an owner may agree to service tenant populations at AMGI levels lower than identified in IRC §42(g); nonperformance of such agreements is not a reportable noncompliance event.

Annual Household Gross Income is the gross income (with no adjustments or deductions) the household anticipates it will receive in the 12-month period *following* the effective date of the income certification. The combined income of all occupants of a unit, whether or not legally related, is compared to the appropriate percentage of the AMGI for a family with the same number of members⁴.

If information is available on changes expected to occur during the year, that information is used to most accurately determine the anticipated income from all known sources during the year. Unanticipated income received after the household moves in will not affect the original determination that a household is eligible for LIHC housing.

State agencies are required to review the low-income certifications, and the supporting documentation, for the tenants in a sample of LIHC units.⁵ Therefore, the state agency must review the initial income certification if the tenant moved in within the last year and the most recent income recertification for continuing tenants. *For state agency reviews

¹ *See IRC §§42(g)(4), 42(i)(8), 142(d)(2)(B) and 1400N(c)(4).*

² Note: Once made, this election is irrevocable and applies to all low-income units. See IRC §§42(g)(1) and 42(i)(3)(A)(ii).

³ *IRC §42(g)(8) is applicable for determinations made after July 30, 2008. See section 3004(f) of the Housing Assistance Tax Act of 2008.*

⁴ See Rev. Rul. 90-89, 1990-2 C.B. 8.

⁵ See Treas. Reg. §1.42-5(c)(2)(ii)(A) and (B).

conducted after July 30, 2008,⁶ where the project is a 100% LIHC project and the owner is not subject to the annual income recertification requirements, the state agency will always review the initial income certification.^{7*}

Determining Income Limits (Area Median Gross Income)

*** Years Prior to 2009*** To determine the appropriate household income limit figure, refer to the HUD-published table relating to “very low income,” which is an income level at or below 50 per cent of the Area Median Gross Income (AMGI). HUD prepares tables and provides income figures for family sizes ranging from one to eight persons.

If the owner elected the 40/60 minimum set-aside, then the published income figures for the 50 per cent of AMGI should be multiplied by 1.2.⁸ There should be no rounding of these figures, as HUD has already rounded *to the nearest \$50* in the tables.

*** Years Subsequent to 2008*** *Beginning with the release of AMGI tables for 2009⁹, HUD is providing a separate table for IRC §§ 42 and 142(d) housing projects, which HUD now collectively refers to as “Multifamily Tax Subsidy Projects” (MTSP).

1. The tables are in the same format as in prior years. The column down the left-hand side identifies the state and area within each state. From left to right, the columns identify the income limits based on household size (1 to 8 persons).
2. The tables identify the income limits at the 50% and 60% AMGI levels needed to satisfy the minimum set-aside requirement. As a result, the instructions in Rev. Rul. 89-24 to compute 60% AMGI are no longer needed.
3. In those areas where the income limits did not decrease in 2007 and 2008 because of HUD’s hold harmless policy, the tables include a second set of income limits identified as “HERA Special 50%” and “HERA Special 60%.” These income limits are applicable if the owner relied on the income limits provided by HUD to determine the income limits applicable to the low-income project and determined whether households were income qualified based on those income limits (adjusted for family size) in either 2007 or 2008. If the project was in service, or placed in service during 2007 or 2008, the owner relied on the income limits provided by HUD and the HERA special income limits should be used.*

⁶ *For reviews conducted before July 31, 2008, if the owner received a waiver of the annual income recertification requirements, the state agency reviewed the initial income certification. See Rev. Proc. 2004-38, section 5.07, 2004-2 C.B. 10, and Rev. Proc. 94-64, Section 4.05, 1994-2 C.B. 797. If noncompliance with the tenant income certification requirements was sufficiently serious, consideration was given to revoking the waiver. Revocation was not required, but the Service would revoke the waiver at the state agency’s request.*

⁷ *See IRC §142(d)(3).*

⁸ Rev. Rul. 89-24, 1989-1 C.B. 24.

⁹ *Section 3009 of the Housing Assistance Tax Act (HATA) amended IRC §142(d)(2) to add a new subparagraph E. IRC §142(d)(2) is cross referenced in IRC §42(g)(4) and is equally applicable to qualified low-income projects under IRC §42.*

Households and Family Size

As a general rule, a “household” consists of all individuals (or tenants) residing in a unit. To determine the household income limit, all applicable income standards are adjusted for family size. For LIHC purposes, all occupants of a unit are considered in the determination of family size except the following (refer to HUD Handbook 4350.3 for complete discussion):¹⁰

1. Live-in aides. A person who resides with one or more elderly persons, near-elderly persons, or persons with disabilities, and who is determined to be essential to the care and well-being of the person(s); is not obligated for the support of the person(s); and would not be living in the unit except to provide the necessary supportive services. While a relative may be considered to be a live-in aide/attendant, they must meet the above requirements. The income of live-in aides is not included in the household’s income.
2. *Foster children and foster adults. Foster children are in the legal guardianship or custody of a State, county, or private adoption or foster care agency, yet are cared for by foster parents in their own homes under some kind of foster care arrangement with the custodial agency. A foster adult is usually an adult with a disability who is unrelated to the tenant family and who is unable to live alone.*
3. Guests. *A visitor temporarily staying in the unit with the consent of the tenant or another member of the household who has expressed or implied authority to consent on behalf of the tenant.*

When determining family size for income limits, the owner must include the following individuals who are not living in the unit:

1. Children temporarily absent due to placement in a foster home;
2. Children in joint custody arrangements who are present in the household 50% or more of the time. *If disputed, determine which parent claimed the children as dependents for purposes of filing a federal income tax return.*
3. Children who are away at school but who live with the family during school recesses;
4. Unborn children of pregnant women (as self-certified by the woman);
5. Children who are in the process of being adopted;
6. Temporarily absent family members who are still considered family members *if approved to live in the unit.* For example, the owner may consider a family member who is working in another state on assignment to be temporarily absent;
7. Family members in the hospital, or a rehabilitation facility, for periods of limited or fixed duration are considered a family member. These persons are temporarily absent; and

¹⁰ IRC §142(d)(2)(B) refers to the income of individuals. The combined income of all occupants of an apartment, whether or not legally related, is compared to the appropriate percentage of the median family income for a family with the [same] number of members. See Rev. Rul. 90-89, 1990-2 C.B. 8.

8. Persons permanently confined to a hospital or nursing home. The family decides if such persons are included when determining family size for income limits. If the family chooses to include the permanently confined person as a member of the household, the owner must include income received by the confined person in calculating family income.

Changes in Family Size

Changes in the size of an existing household after the initial tenant income certification must also be addressed.

Family Size Increases

The addition of new member(s) to an existing low-income household requires the income certification for the new member of the household, including third party verification. *The treatment will depend on whether the building is a mixed-use or 100% LIHC building.

Mixed-Use Projects

For mixed-use projects, the* new tenant's income is added to the income disclosed on the existing household's *most recent* tenant income certification.¹¹ The household continues to be income-qualified, and the income of the new member is taken into consideration with the income of the existing household for purposes of the Available Unit Rule under IRC §42(g)(2)(D). See chapter 14.

Example 1: Additional Person Joins Household During the Year

Jim and his two children initially income qualified and moved into an LIHC unit on March 1, *2005*. The project is a mixed-use project consisting of one building with 50 low-income units and 25 market rate units.* The household continued to qualify at the annual income recertification for *2006, 2007, and 2008.* Jim then met Jane, and they decided to marry in October *2008.* The new couple would like to live in the LIHC unit Jim occupies. Jane completes a tenant income certification.

The certification effective date continues to be March 1, *2005* and the next annual income recertification is due within 120 days before March 1, *2009.*

If the household's income, when Jane's income is added *to the existing household's income as determined for the March 1, 2009 annual recertification,* exceeds 140 percent of the income limit (170 percent in deep rent skewed projects), then *the unit is an over-income unit and* the Available Unit Rule *is applicable.

¹¹ Under IRC *§142(d)(3)(A) and* Treas. Reg. 1.42-5(c)(iii), owners must obtain an *annual* income certification from each low-income tenant *if the low-income building is part of a mixed-use low-income project.* Interim income recertifications are not *required* under IRC §42.

100% LIHC Projects

If the project is a 100% LIHC project¹², then the new tenant's income is added to the income disclosed on the existing household's original income certification.*

Example *2: Owner is not Subject to Annual Income Recertification Requirement

Mary and her two daughters initially income qualified and moved into an LIHC unit on March 1, 2005. The project is a 100% LIHC project for which the owner had a waiver of the income recertification under Rev. Proc. 94-64 for periods ending before August July 30, 2008. Mary never completed an annual income recertification for 2006 through 2008, and under IRC § 142(d)(3), will not be required to complete an income recertification in the future.

Mary met Bill and they decided to marry in October 2008. The new couple would like to live in the LIHC unit Mary occupies. Bill completes a tenant income certification and moves into the unit on October 25, 2008.

The certification effective date continues to be March 1, 2005, but no annual income recertification is required. Since the owner will always rent the next available unit to an income-qualified household as a low-income unit, the Available Unit Rule will not be violated if the household's income, when Bill's income is added to Mary's income at the time she moved in with her daughters, exceeds 140 percent of the income limit (170 percent in deep rent skewed projects).*

Original Household No Longer Occupies Unit

A household may continue to add members as long as at least one member of the original low-income household continues to live in the unit. Once all the original tenants have moved out of the unit, the remaining tenants must be certified as a new income-qualified household unless:

1. *For mixed-used projects, the newly created household was income qualified, or the remaining tenants were independently* income qualified at the time they moved into the unit.
2. *For 100% LIHC buildings, the remaining tenants were independently income qualified at the time they moved into the unit.*

¹² *The same rule applies if, before July 31, 2008, the owner received a waiver of the income recertification requirement under Rev. Proc. 2004-28 or Rev. Proc. 94-64.*

***Example 3: Remaining Tenants Must be Income Qualified**

Michael, an income-qualified individual, moved into a two bedroom LIHC unit in a mixed-used project on May 20, 2006. Jason joined the household in October of 2007. At that time, Michael and Jason's combined income was below the limit for a two person household. In January of 2008, Michael moved out. It is not necessary for Jason to be certified as a new tenant.

However, if Michael and Jason's combined income exceeded the income limit for a two-person household in October of 2007, then Jason must be certified as an income-qualified tenant when Michael moves out.*

If a state agency determines that the tenants manipulated the income limitation requirements, then the unit should not be treated as a low-income unit as of the date the household initially occupied the unit.

Example 4: New Tenants Manipulated Income Limitations

An income-qualified household consisting of one person moved into a two bedroom unit on March 15, 2005. A second tenant completed an initial income certification and joined the household soon thereafter. The combined income of the two tenants is above in income limit for a household with two members. The unit is out of compliance as of March 15, 2005.

Family Size Decreases

Decreases in family size do not trigger the immediate income certification of a new household. Subsequent annual income recertifications will be based on the income of the remaining members of the household. If the remaining household's income is more than 140 percent (170 percent in deep rent skewed projects) of the income limit at the time of the annual income recertification, then the Available Unit Rule is applicable.¹³

Example 1: Member of the Household Leaves

A married couple, with their two children, was initially income qualified and occupied a three bedroom unit. After four years, the oldest child, now 18 years old, moves out of the unit. It is not necessary to certify the remaining household as a new household. If the household's income exceeds *140 percent of the income limit (170 percent in deep-skewed projects)* for a family with three members at the next income recertification, the Available Unit Rule is applicable.

¹³ See the legislative history for IRC §42, which notes that if the tenant's income increases to a level more than 140 percent above the otherwise applicable ceiling (*or if the tenant's family size decreases so that a lower maximum family income applies to the tenant*), that tenant is no longer counted in determining whether the project satisfies the set-aside requirement. The explanation continues, stating that there is no penalty in such cases if the Next Available Unit Rule is applied.

Example 2: Unborn Children

A household was originally income qualified based on the inclusion of an unborn child. Four months later, the pregnancy ended in miscarriage. It is not necessary to certify the remaining household as a new tenant at the time of the miscarriage. If the income of the remaining household members exceeds *140 percent of the income limit (170 percent in deep rent-skewed projects)* at the next income recertification, the Available Unit Rule is applicable.

Verifying Income and Assets

Owners must verify all known income and assets that affect eligibility. However, if the total assets for a household are \$5,000 or less, the applicants may satisfy the asset requirement by signing a statement attesting to such fact.¹⁴

Acceptable methods of verifying information include third party verifications, reviews of documents submitted by the tenant (such as check stubs), and tenant certifications made under penalties of perjury.¹⁵

Third party contacts are preferred. Owners should obtain the tenant's consent for the release of information before contacting third parties. Verification forms should be directly sent to and received from third parties. If third party contacts are by telephone or interview, the conversation should be documented in the tenant's file and include all the information that would have been included in a written verification. The owner may obtain acceptable third party written verification by facsimile, e-mail, or Internet.

Owners can accept tenant-provided documents (e.g., pay stubs, Forms W-2, bank statements, etc.) when third party contacts are impossible or delayed, or third party verifications are not needed (e.g., birth certificates or divorce decrees).¹⁶

There will be situations where it will be difficult to estimate income. For example, the tenant may work sporadically or seasonally. In such cases, owners are expected to make a reasonable judgment as to how to the most reliable approach to estimating what the tenant will receive in the coming year.

Determining Annual Income

Household income is defined as the gross income (with no adjustments or deductions) the household anticipates it will receive in the 12-month period following the effective date of the household's certification of income.¹⁷ *If the household's income cannot be determined based on current information because the household reports little to zero

¹⁴ See Rev. Proc. 94-65, 1994-2 C.B. 798.

¹⁵ Treas. Reg. §§ 1.42-5(b)(vii) and 1.42-5(c)(1)(iii).

¹⁶ Third party contacts are considered impossible if an employer does not respond, third party charges a fee, or no third party is available. Generally a third party contact is considered delayed if a response will not be received within two weeks, but can be less if it is determined that the third party will not respond.

¹⁷ As explained in Treas. Reg. §1.42-5(b)(vii), gross income for purposes IRC §42 is not gross income for purposes of determining a federal income tax liability.

income, or income fluctuates, income may be determined based on actual income received or earned within the last twelve months before the determination.^{18*}

Income includes, but is not limited to, earned and unearned income from all household members age 18 and older (adults, *including foster adults^{19*}), unearned income of minor children *and foster children²⁰ under the age of 18*, and income from assets. Emancipated minors, *persons under the age of 18 who have entered into a lease under state law,* are treated as adults.

*The treatment of a student's income is dependent on the age of the student, the type of income, and the status of the student within the household. It doesn't matter whether the student is living with the household or is away at school.

1. If the full-time student is 18 years of age or older and is the head of the family, spouse or co-head, all income is included.
2. If the full-time student is 18 years of age or older and a dependent, only the lesser of actual earned income or \$480 is included, along with unearned income and income from assets.
3. If the full-time student is a minor (under the age of 18), then only unearned income and income from assets is included. No income from employment is counted.

The treatment of educational scholarships and grants is discussed later in this chapter.*

As noted in chapter 5 of HUD Handbook 4350.3, "In all instances, owners are expected to make a reasonable judgment as to the most reliable approach to estimating what the tenant will receive during the year."²¹

Common sources of income are discussed below. Refer to HUD Handbook 4350.3, *Chapter 5,* for additional information.

Employment Income

Employment income includes (but is not limited to) hourly wages, salaries, overtime pay, tips, bonuses, and commissions before any payroll deductions. Payments in lieu of employment income are also included; e.g., workers compensation, severance pay, unemployment and disability compensation. *Earned* income from employment of children (including foster children) is excluded.

Maximum benefits and annualized payments should not be used unless the source of funds is expected to continue throughout the certification period or for an indeterminable length of time. For example, if the third party does not indicate the length of time for which the tenant will be receiving a certain income, then the income should be annualized. In the event that the family cannot provide documentation that access to a specific source of income is for a limited and determinable time period, the benefits should be considered to be available for an indefinite time period and annualized.

¹⁸ *74 FR 4841-4842, regulatory changes to 24 CFR 5.609.*

¹⁹ Effective August 1, 2009.

²⁰ Effective August 1, 2009.

²¹The HUD Handbook 4350.3, Chapter 5, paragraph 5-5(C).

Example 1: Benefits for Indefinite Time Period

John works as a telemarketer for \$9.00 an hour, 40 hours a week. He does not work overtime, has no other source of income, and is not planning to leave his job. His anticipated income is computed as:

$$(\$9.00/\text{hour}) \times (40 \text{ hours/week}) \times (52 \text{ weeks/year}) = \$18,720/\text{year}$$

Example 2: Benefits for Definite Time Period

A teacher's assistant works nine months annually and receives \$1,300 per month. During the summer recess, the teacher's assistant works for the Parks and Recreation Department for \$600 a month. The teacher's anticipated income is computed as:

$$(\$1,300 \times 9 \text{ months}) + (\$600 \times 3 \text{ months}) = \$13,500$$

If information is available on changes in income expected to occur during the year, use that information to determine the total anticipated income from all know sources during the year.²²

Example 3: Anticipated Changes in Income

In May 2004, an unemployed plumber applies for LIHC housing. At that time, the plumber is receiving unemployment benefits of \$250.00 per month and will qualify for benefits for 4 more months.²³ Beginning in October, the plumber will be employed at \$1,000 per month. The plumber's anticipated income is computed for the period from May to September, 2004 plus the income for October 2004 through May 2005.

$$(\$250.00 \times 5 \text{ months}) + (\$1,000 \times 7 \text{ months}) = \$8,250$$

*Owners are expected to make reasonable judgments regarding the most reliable method for estimating the income a household will receive during the year. *If the tenant's income cannot be determined using current information, the owner may include actual income received or earned within the 12-month period before the determination of annual income.*

Example 4: Sporadic Employment

Justine is disabled and not always able to work full-time. She has income from disability insurance and a family trust, and also works as a typist with a temporary agency when she is well. Last year she worked nearly six months, but at the time she applies for an LIHC apartment, she has more medical problems and does not know when or how much she will be able to work.

²² See Footnote #2.

²³ The HUD Handbook 4350.3, Chapter 5, paragraph 5-5(A)(1) refers to unemployment compensation as an example of income that *may* not last for a full 12 months.

*Because Justine is not working at the time of the certification and actual income from her sporadic employment as a typist cannot be reasonably determined, the income earned during the six-month period in the prior year should be included in the income certification.

NOTE: An owner must make a reasonable judgment. The prior year's income should not be used to estimate Justine's future income if she can provide sufficient documentation that her earning capabilities have changed; e.g., her contract with the temporary agency has been terminated.*

Payments received under the Domestic Volunteer Service Act of 1973 are excluded from income. This includes employment through VISTA, Retired Senior Volunteer Program, Foster Grandparents Program, youthful offender incarceration alternatives, and senior companions. Payment received under Title V of the Older Americans Act (Green Thumb, Senior Aides, Older American Community Service Employment Program) is also excluded.

***Military
Employment***

Military employment may include (but is not limited to) base and longevity pay, proficiency pay, sea and foreign duty pay, hazardous duty pay, subsistence and clothing allowances. All these are includable in income. Hostile fire pay, however, is excluded from income. *Note:* a temporarily absent individual on active military duty must be removed from the family and his or her income must not be included in the computation of household income, unless (1) that person is the head of the family, spouse, or co-head *or (2), the spouse or a dependent of the person on active military duty resides in the unit.

Military Basic Housing Allowance

Military basic housing allowances are also included in income. However, under IRC §142(d)(2)(B)(ii)²⁴, military basic housing allowances are *not* included in household income if the low-income building is located in any county, or adjacent county, in which is located a qualified military installation. A qualified military installation is any military installation or facility to which:

1. not less than 1,000 members of the Armed Forces are assigned, and
2. the number of members of the Armed Forces assigned to units based out of such qualified military installation, as of June 1, 2008 has increased by not less than 20 percent, as compared to such number on December 31, 2005.

Qualifying military bases are identified in Notice 2008-79.²⁵ The list is not meant to be exclusive and any qualified military installation which satisfies the percentage requirements of IRC §142(d)(2)(B)(iii)(1) would be eligible to receive similar treatment regardless of its failure to be included in Notice 2008-79 or any subsequent updates.

²⁴ *IRC §142(d)(2)(B)(ii) was added under section 3005(a) of the Housing Assistance Tax Act of 2008.*

²⁵ *Notice 2008-79, 2008-40 I.R.B. 815. The IRS will update the list if it receives additional information indicating that other military installations should receive the same treatment. Owners may rely on this list for income determinations made after July 30, 2008 and before any successor list is published.*

1. Colorado – U.S. Air Force Academy
2. Hawaii – Fort Shafter
3. Kansas – Fort Riley
4. Maryland – Annapolis Naval Station (including U.S. Naval Academy)
5. South Carolina – Fort Jackson
6. Texas – Fort Jackson and Fort Hood
7. Virginia – Dam Neck Training Center Atlantic
8. Washington – Naval Station Bremerton

The exception under IRC §142(d)(2)(B)(ii) applies to:

1. determinations of income made after July 30, 2008 and before January 1, 2012, if (1) the IRC §42 credits were allocated²⁶ on or before July 30, 2008 or, (2) if financed with tax-exempt bonds, the building was placed in service before July 30, 2008, but only if the bonds were issued before July 30, 2008.
2. determinations of income made after July 30, 2008 if (1) the IRC §42 credits were allocated after July 30, 2008 and before January 1, 2012, or (2) if financed with tax-exempt bonds, the building is placed in service after July 30, 2008 and before January 1, 2012, but only if the bonds were issued after July 30, 2008 and before January 1, 2012.

The low-income building owner is responsible for documenting that the exception under §142(d)(2)(B)(ii) is applicable.*

***Deployment of Military Personnel to Active Duty**

Owners are encouraged to accommodate the unique circumstances of households where a member is called to active duty in the Armed Forces. Specific actions that owner can take and remain in compliance include, but are not limited to:

1. Allow a guardian to move into the low-income unit on a temporary basis to provide care for any dependents the military person leaves in the unit. The guardian's income is not included in the household's income.
2. Allow a tenant living in a low-income unit to provide care for any dependents of persons called to active duty in the Armed Forces on a temporary basis as long as the head and/or co-head of the household continues to service in active duty. Income of the dependent (e.g., SSI benefits, military benefits) is not included in the household's income.
3. Allow leases to remain in effect for a reasonable period of time without recertification (if required) depending on the length of deployment beyond that required by the Soldiers' and Sailors' Civil Relief Act of 1940, 50 U.S.C. §§501-591, even though the adult members of the military family are temporarily absent from the assisted unit.*

Income from Training Programs

Compensation from state or local employment training programs or training of a family member as resident management staff is not included in income. Income from training programs not affiliated with a local government and income from the training of a family

²⁶ *The date of allocation is the date the allocating document under IRC §42(h) is signed.*

member resident to serve on the management staff are also excluded. Amounts excluded by this provision must be received under employment training programs with clearly defined goals and objectives, and are excluded only for a limited period as determined in advance under the program by the state or local government.

Amounts received under training programs funded by HUD are not included in income. Similarly, payments received under programs funded in whole or in part under the Workforce Investment Act (WIA – formerly the Job Training Partnership Act) are excluded from income. These are employment and training programs for Native Americans and migrant and seasonal farm workers, Job Corps, veterans employment programs, state job training programs, career intern programs, and AmeriCorps. Amounts received by a person with a disability that are disregarded for a limited time for purposes of supplemental security income eligibility and benefits because they are set-aside for use under a Plan to Attain Self-Sufficiency (PASS) are excluded from income.

Excluded compensation includes stipends, wages, transportation or childcare payments received, or reimbursements of out-of-pocket costs and which are made solely to allow participation in a specific program. Income received as compensation for employment is excluded only if the employment is a component of a job-training program. Once training is completed, the employment income is included in the computation of annual income. Amounts received during the training period from unrelated sources (public assistance, social security payments, other employment) are not excluded from income.

Income from a Business

The net income from the operation of a business, profession, or sole proprietorship businesses is included in income. Net income is gross income less business expenses, interest on loans, and depreciation computed on a straight-line basis. Salaries paid to the applicant or other household members from the business must also be identified and included in income. *In addition, cash and assets withdrawn by family members must be included in income except when the withdrawal is a reimbursement of cash or assets invested in the business.*

Business expenses do *not* include principal payments on loans, interest on loans for business expansion or capital improvements, or other expenses for business expansion or outlays for capital improvements.

If the net income from a business is negative, it must be counted as zero income. A negative amount cannot be used to offset other family income.

Example 1: Negative Income from Sole Proprietorship

John and Mary, a married couple, apply for LIHC housing. John operates a sole proprietorship business; the net income from the business after expenses last year was -\$3,500. Mary earns \$27,000 each year as an employee, as shown on the W-2 from her employer. The household's income is \$27,000. The \$3,500 loss generated by John's business cannot be used to offset Mary's wages.

Income from a sole proprietorship can be estimated by reviewing the individual's prior year tax returns and Schedules C. If necessary, the owner can ask the potential tenant to provide a signed Form 8821, which will allow the owner to verify the information with the IRS. *Note: A tax return must be filed for all self-employed individuals who

operate sole-proprietorship businesses or otherwise report income on Schedule C, regardless of whether the taxpayer is reporting a profit or a loss. If the person is not eligible to get an SSN, which is needed to file a tax return, an individual taxpayer identification number (ITIN) can be obtained using IRS Form W-7.*

Example 2: Using the Prior Year Tax Return

A potential LIHC tenant is self-employed and expects the business to continue indefinitely. The potential tenant submitted the tax return for the last year. The net income from the sole proprietorship was \$13,000. The \$13,000 figure can be used as income anticipated for the next 12 months.

Alternatively, the potential tenant can annualize income from self-employment for the current year business activity based on the number of full months in business. The formula is:

$$\frac{\text{(Net Income Year to Date)} \times 12 \text{ months}}{\text{Number of Months in Business during the Current Year}}$$

Example 3: Annualized Current Year Self-Employment Income

In September, a potential tenant prepared a Schedule C showing the income and expenses for the current year, from January 1 through August 31, using the tax form from the prior year. To date, the potential tenant has net income of \$24,000. The anticipated income is determined by multiplying \$24,000 by 12/8, which equals \$36,000. This is an acceptable estimate of future earnings.

*Office in the Home

A low-income tenant may use a portion of a low-income unit exclusively and on a regular basis as a principle place of business, and claim the associated expenses as tax deductions, as long as the unit is the tenant's primary residence. If the tenant is providing daycare services, the tenant must have applied for (and not have been rejected), be granted (and still have in effect), or be exempt from having a license, certification, registration, or approval as a daycare facility or home under state law. For more information, refer to Form 8829, Expenses for Business Use of Your Home, the form's instructions, and Publication 587, Business Use of Your Home (Including Use by Daycare Providers).

Example 4: Use of Residential Rental Unit as Home Office

A self-employed bookkeeper wishes to rent a two bedroom unit and intends to use one bedroom as her principle place of business; i.e., to provide bookkeeping services. She provides her tax return for the last year, which includes a Schedule C, as verification of her income. The Schedule C includes an "office expense" for her home office in a prior residence. There's also a Form 8829 included with the return.*

**Income from
Rental Property,
Partnerships,
S-Corporations,
and Royalties**

Rental property may be real estate or personal property such as equipment or vehicles. The tenant may have income from enterprises doing business as partnerships or s-corporations, or receive royalties for copyrights or patents.

Assets

There is no limit on the amount of assets a household may hold and a household is not required to convert an asset to cash.

Assets include bank accounts, trusts, stocks and bonds, the surrender value of life insurance policies, and cash kept in safety deposit boxes or at home. One time, lump sum distributions are considered assets; e.g., inheritances, capital gains, victim's restitution and settlements on insurance claims. Lottery winnings paid in one lump payment are treated as assets. Lottery winnings paid in periodic payments must be counted as income. Lump sum payments of deferred periodic payments of supplemental security income and social security benefits are also considered assets.

For non-cash assets held for investment, the cash value is the net amount the household would receive if the assets were converted to cash. The cash value is the market value, or the amount another person would pay to acquire the asset, less the cost to turn the asset into cash.

Assets do not include necessary personal items such as clothes, furniture, cars, wedding rings, or vehicles specially equipped for persons with disabilities. Assets used in a business are not assets included in the computation of the tenant's income. If an asset is held in the tenant's name, but the income generated by the asset accrues to someone who is not a member of the household and the other person is responsible for income taxes on the accrued income, then the asset is not included in the tenant's income.

Lump-sum additions to the household's assets, such as inheritances, insurance proceeds (including payments under health and accident insurance and worker's compensation), capital gains, and settlements for personal or property losses are excluded from income.

Example 1: Exhausting an Asset

A tenant receives a lump sum inheritance of \$12,000 and deposits the money in a savings account. The asset is disclosed and the income from the asset correctly accounted for at the time of the initial income certification. The tenant subsequently withdraws \$1,000 each month to pay personal living expenses. A year later, when the annual income recertification is completed, the bank account balance is zero.

The monthly withdraws retain their character of an asset; i.e., they are not considered income. There is no need to include the bank account as an asset in subsequent annual income recertifications since the balance is zero.

Assets disposed of for less than fair market value within two years of the effective date of a tenant's initial certification or recertification, including assets placed in irrevocable trusts, are included in the tenant's income. Assets are considered to be disposed of for less than fair market value if the cash value of the assets disposed of exceeds the gross amount the tenant received by more than \$1,000.

***Example 2: Tenant Disposed of Assets for Less Than Fair Market Value**

During April of 2009, Jackson Jones gave each of his three children \$500. In September of 2009, he applied for low-income housing. Because the total (\$1,500) exceeds the \$1,000 limit, the gifts are treated as assets disposed of for less than fair market value and are included as income on his application.

Note: The gifts should also be reported as income for the 2010 income recertification if the low-income unit is in a mixed-use building. See chapter 14 for details.*

Do not include assets disposed of for less than fair market value as the result of a foreclosure, bankruptcy, or divorce or separation agreement if the applicant or tenant receives valuable consideration not measurable in dollars.

Assets must be verified, the income generated from assets must be determined, and the income included in the computation of the household's income.

1. If the total cash value of a household's assets is more than \$5,000, imputed income must be calculated using the current HUD passbook rate²⁷ and the greater of the actual income or imputed income must be included in the household's income. Refer to the HUD Handbook 4350.3, paragraph 5-7F, *for the passbook rate, which is currently set at 2%.*
2. If the total cash value of the household's assets is \$5,000 or less, the actual income the tenant receives from assets is the amount included in annual income as income from assets. An owner may satisfy asset verification requirements by *annually* obtaining a signed, sworn statement from the tenant certifying that the tenant's net family assets are \$5,000 or less and disclosing the tenant's annual income from net assets. Owners, however, may not rely on a low-income tenant's signed, sworn statement of income from assets if a *reasonable person*²⁸ in the owner's position would conclude that the tenant's income is higher than the amount presented by the tenant. In such cases, the owner must obtain other documentation of the low-income tenant's annual income from assets to satisfy documentation requirements.²⁹

Income from Investments

*Stocks, bonds, Treasury bills, certificates of deposit, mutual funds, and money market accounts are assets. Interest or dividends earned are included as income even when the earnings are reinvested.

²⁷ Projects receiving a tax credit allocation for rehabilitation of USDA Rural Development properties typically use the USDA Rural Development passbook rate if imputed interest must be included in the income computation.

²⁸ The "reasonable person" concept is part of the definition of due diligence. Due diligence is defined (*Black's Law Dictionary [6th ed. 1990]*) as: "Such measure of prudence, activity, or assiduity, as is properly to be expected from, and ordinarily exercised by, a reasonable and prudent person under the particular circumstances; not measured by any absolute standard, but depending upon the relative facts of the special case." In short, the due diligence standard is a judicially created test to determine the adequacy of the efforts exerted throughout all phases of any activity.

²⁹ See Rev. Proc. 94-65, 1994-2 C.B. 798.

Example 1: United States Savings Bonds

A potential tenant buys a United States savings bond for \$50 each month through a savings program offered by his employer. At the time of his application for housing, he is holding 18 bonds, which have a face value of \$931; i.e., \$900 investment and \$31 accumulated interest. The savings bonds are included as assets and the anticipated interest that will be earned is included as income even though the interest is added to the value of the bond.*

Contract Sales of Real Estate Assets

A tenant may sell real estate using an installment contract (or similar agreement) that provides a stream of payments over a period of time. A portion of the payment will be applied to the principal and a portion will be interest income. The interest should be included in income; the outstanding principal *as the effective date of the certification is considered an asset. The value of the asset will decrease over time as the loan is repaid.*

Periodic Social Security Payments

The gross amount of periodic Social Security payments, before deductions, is included in income. Payments received by adults on behalf of individuals under the age of 18 or by individuals under the age of 18 for their own support are also included.

When social security or SSI benefit income is paid in a lump sum as a result of deferred periodic payments, that amount is excluded from income.

Periodic Payments, Retirement Accounts, Annuities, and Trusts

The full amount of periodic payments from *annuities, insurance policies, retirement funds, pensions and disability or death benefits is included in income. Examples of periodic payments include* Black Lung Sick benefits, Veterans Disability, Dependent Indemnity Compensation, and payments to the widow of a serviceman killed in action. *Payments from long-term care insurance (in excess of \$180 a day) are included in income.

Federal government/*Uniformed Services, state, local government, social security or private* pension funds are not included in income if paid directly to a former spouse according to the terms of a court decree of divorce, annulment or legal separation.

However, if a tenant is the former spouse and is receiving any amounts pursuant to a court ordered settlement in connection with a divorce, annulment of marriage, or legal separation (reflected on a Form 1099), the amount is included in the tenant's income.

***Retirement Accounts**

Balances in Individual Retirement Accounts (IRAs), 401K's, Keogh plans and similar retirement savings accounts are considered assets if the money is accessible to the household.

1. For employed individuals, accessible amounts are considered assets even if withdrawal would result in a penalty; however, amount that are only accessible only if the individual is retired are not included.
2. For employed individuals, include only the amount that can be withdrawn without retiring or terminating employment.
3. After retirement, the amount received as a lump sum is considered an asset.

Any retirement benefits received as periodic payments are included in annual income.

Annuities

If a member of the household is receiving annuity payments and is not able to withdraw the balance as a lump sum of cash, the payments are treated as income and no calculation of income from an asset is made. If the balance of the annuity can be withdrawn, the annuity is treated as an asset. In addition to the income earned from the annuity, the cash value of the annuity must also be determined.

The cash value is the full value of the annuity, minus any surrender (or withdrawal) penalty, minus any taxes and tax penalties that would be due, and is the value used to compute the imputed income of the household's assets. The actual income is the balance in the annuity multiplied by the percentage at which the annuity is expected to grow over the coming year.*

Trusts

1. *If any member of the household has the right to withdraw the funds in the account, the trust is considered an asset and treated as any other asset. The cash value of the trust is added to total net assets. The actual income received is added to actual income from assets.
2. If only the income, but none of the principal, is currently available to a member of the household, the income is counted in annual income, but the trust is not included in the calculation of income from assets.
3. If no member of the household has access to either the principal or income of a trust, the trust is not included in the calculation of income from assets or in annual income.
4. If a member of the household receives a portion of the trust's principal on a regular basis, the payments are included in annual income.³⁰

If a member of the household creates a nonrevocable trust for the benefit of another person while residing in assisted housing, the trust is considered an asset disposed of for less than fair market value.

1. If the trust's income is regularly reinvested in the trust, the value of the trust is calculated as any other asset disposed of for less than the fair market value for two years and not taken into consideration thereafter.
2. If the household member continues to receive income from the trust, the income is added to annual income and the trust is counted as an asset disposed of for less than the fair market value for two years. Thereafter, only the actual income distributed from the trust is included in income.*

Documentation

Benefit letters or annual statements prepared by third parties are sufficient documentation. Verification may also include bank statements noting the transfers of funds.

³⁰ *See HUD Manual 4350.3, Chapter 5, section 5-6(G)(1)(b)(5).*

Public Assistance

Amounts specified for shelter and utilities should be separately stated. They may be excluded from income. Special computations are needed; consult the HUD Handbook 4350.3 for details.

***Example 1: Utility Allowance is Greater than Tenant's Portion of Rent**

Under HUD's section 8 program, the portion of the rent paid by the household is calculated as a percentage of the household's monthly income and subtracting a utility allowance if the household pays utilities. In some cases, the utility allowance will be greater than the household's portion of the rent and the households will receive a utility reimbursement to assist in meeting utility costs. The reimbursement is not included in income.*

Payments, rebates or credits received under the Federal Low-Income Home Energy Assistance Program are excluded from income. Also exclude any winter differentials given to the elderly.

Special calculations of public assistance income are required for as-paid state, county or local public assistance programs. Consult the HUD Handbook for detailed instructions.

Recurring Gifts, Grants and Contributions

Regular, recurring monetary and nonmonetary gifts or contributions to residents from persons not living in the unit must be included in income. This can include the payments of bills on behalf of a resident. For example, if a parent or family member will be paying a resident's utility bill each month directly to the utility company, those payments are still counted as income for the tenant. However, the value of groceries provided by someone outside the household, and the food portion of public assistance, even if provided routinely, is *not* included.

Example 1: Use of Vehicle

A tenant uses her ex-husband's car to transport their son to medical examinations conducted on a regular basis. The title to the car is in the ex-husband's name, he makes the car payment, and he is responsible for maintenance.

The use of the car should not be considered a regular non-cash contribution to the household unless the tenant has exclusive use of the vehicle.

Grants received specifically for medical expenses, set aside for use under a Plan to Attain Self Sufficiency (PASS) and excluded for purposes of Supplemental Social Security (SSI) eligibility, or for out-of pocket expenses for participation in publicly assisted programs (expenses include the costs for special equipment, clothing, transportation, child care, etc.) are excluded.

Generally, *"amounts" paid directly to a childcare provider by persons not living in the unit for a tenant's childcare are not included in income. This exclusion is based on a handbook interpretation of reimbursed childcare expenses under the definition of Adjusted Income and its bearing on Annual Income. See 24 CFR Parts 813.1, 215.1, and 236.1. In relevant part, the regulations define childcare expenses to include "amounts to be paid by the family for [child care]...to the extent [they are] not reimbursed." Handbook 4350.3 indicates that childcare expenses that are not reimbursed are not

included as annual income. However, if such childcare is paid by a *non-custodial* parent in lieu of all, or part, of child support payments, then it should be included in income.

Educational Scholarships or Grants

*The treatment of educational scholarships or grants is dependent on whether the student is receiving Section 8 assistance.

Not Receiving Section 8 Assistance

All forms of student financial assistance, no matter how it is used, are excluded from annual income. Financial assistance includes grants, scholarships, educational entitlements, work study programs, and financial aid packages. It doesn't matter whether the assistance is paid to the student or directly to the educational institution.

Receiving Section 8 Assistance

All financial assistance received from the following sources in excess of tuition is includable in income.

1. The Higher Education Act Assistance under the Higher Education Act of 1965³¹, including Pell Grants, Federal Supplemental Educational Opportunity Grants, Academic Achievement Incentive Scholarships State assistance Partnership Program, the Robert G. Byrd Honors Scholarship Program, and the Federal Work Study programs.
2. Private sources (nongovernmental) of assistance, including assistance provided by a parent, guardian or other family member, whether residing within the family in the section 8 assisted unit or not, or from other persons not residing in the unit.
3. Institutions of higher education, when the specific institution and scholarship amount are referenced. An institution of higher learning provides education beyond high school (or equivalent), is accredited (or has reaccreditation status), is legally authorized to provide a program of education beyond the high school level, awards a bachelor's degree or provides a two-year program that is acceptable for full credit towards such a degree, The institution may be public or nonprofit.

Institutions of higher education also includes any school providing education beyond high school (or equivalent), that is accredited (or has reaccreditation status), is legally authorized to provide a program of education beyond the high school level, which provides not less than a one year program of training to prepare students for gainful employment in a recognized occupation. The institution may be public or nonprofit.

Finally, an institution of higher learning includes public and nonprofit private educational institutions in any state that, in lieu of providing education beyond high school, admits students who are beyond the age of compulsory school attendance in the state in which the institution is located.

Financial assistance received from one of the sources above, in excess of tuition, is not includable in income if either of the two following exceptions is applicable:

³¹ See 20 U.S.C. 10001 *et seq.*

1. The student is over the age of 23 with dependent children, or
2. The student is living with his or her parents who are *applying for or* receiving Section 8 assistance.*

Financial assistance does not include loan proceeds for the purpose of determining income.³²

Temporary, Nonrecurring, or Sporadic Income

Irregular, nonrecurring monetary gifts or contribution to resident are not included in income.

Alimony or Child Support

Alimony or child support that is court ordered or supported by a written agreement should be included in income unless the recipient certifies that the funds were not received and reasonable efforts have been made to collect the amount due, including filing with courts or agencies responsible for enforcing payments. When no documentation of child support, or alimony stipulated in a divorce decree or separation is available, the owner may require the family to sign a certification stating the amount received. The certification must be notarized. Documentation of the collection efforts made may be requested.

A signed, sworn self-certification by a tenant is sufficient documentation under Treas. Reg. 1.42-5(b)(1)(vii) to show that a tenant is not receiving child support payments and is consistent with the documentation requirements in Rev. Proc. 94-65.³³ In addition to specifying that a tenant is not receiving any child support payments, an annual signed, sworn self-certification should indicate whether the tenant will be seeking or expects to receive child support payments within the next 12 months. If the tenant possesses a child support agreement, but is not presently receiving any child support payments, the tenant should include an explanation of this and all supporting documentation; i.e., a divorce decree or court documents. Also, the self-certification should indicate that the tenant will notify the owner of any changes in the status of child support.³⁴

A state agency monitoring procedure, however, may not permit an owner to rely on a low-income tenant's signed, sworn statement indicating that the tenant is not receiving child support payments if a reasonable person in the owner's position would conclude that the tenant's income is higher than the tenant's represented annual income. In this case, the owner must obtain other documentation of the low-income tenant's annual child support payments to satisfy the documentation requirement in Treas. Reg. 1.42-5(b)(1)(viii).

A state agency's monitoring procedure may require that an owner obtain documentation, other than the statement described above, to support a low-income tenant's annual certification of child support payments.

Unearned Income of Minor Children

Any unearned income of children under the age of 18 is included in income. This is any income other than employment income; e.g., interest income from bank accounts or

³² Page 18146, Federal Register Vol. 71.

³³ The signed, sworn self certification under Rev. Proc. 94-65 is equivalent to the notarized certification under HUD Handbook 4350.3, Chapter 5, paragraph 5-6E. See also paragraph 5-13D.

³⁴ See Rev. Rul. 2004-82, Q&A #12, 2004-2 C.B. 350.

dividends from mutual funds held in their name. Unearned income of minor children should be included even if the child is temporarily absent.

Resident Services Stipend

Resident service stipend is a modest amount received by a resident for performing a service for the owner, on a part-time basis, that enhances the quality of life in the LIHC housing. Such services include, but are not limited to, fire patrol, hall monitoring, lawn maintenance, and resident initiatives coordination. If the resident stipend exceeds \$200 a month, the stipend is included in income. If the stipend is \$200 or less, the stipend is excluded from income.

Items Excluded from Income (Miscellaneous)

This section includes a description of miscellaneous sources of funds and how they should be treated for purposes of determining the household's income. Refer to HUD Handbook 4350.3, Chapter 5, and Exhibit 5-1 for additional information.

1. Lunches and food received through food programs such as Women, Infants and Children (WIC), amounts received under the School Lunch Act, Meals on Wheels, food stamps, are not included in income.
2. Amounts paid to a family to offset the costs of services or equipment needed to keep a developmentally disabled family member at home are excluded. By Federal statute, the value of food stamps is not included in income.
3. Amounts received by the household that are specifically for, or in reimbursement of, the cost of medical expenses for any member of the household are not included in income.
4. Adoption assistance payments in excess of \$480 per adopted child are not included in income.
5. Payments received for the care of foster children or foster adults are not included in income.
6. Personal loans, since they must be repaid, are not included in income.
7. Amounts received by the household in the form of refunds or rebates under state or local law for property taxes paid on the dwelling unit are not included in income.
8. Reparation payments paid by a foreign government pursuant to claims filed under the laws of that government by persons who were persecuted during the Nazi era are not included in income. Examples include payments by the German or Japanese governments for atrocities committed during the Nazi era.
9. Any amount of crime victim compensation (under the Victims of Crime Act) received through crime victim assistance (or payment or reimbursement of the cost of such assistance) as determined under the Victims of Crime Act because of the commission of crime against the applicant under the Victims of Crime Act (42 U.S.C. 10602) is not included in income.
10. Income from assets, and amounts received on behalf of, someone who does not reside in the household are not included in income, as long as (1) the amounts are not intermingled with the household's funds and (2) the amounts are used solely to benefit the person who does not reside within the household. For

such amounts to be excluded from income, the individual must provide the owner with an affidavit stating that the amounts are received on behalf of someone who does not reside with the family and that the amounts meet the conditions stated above.

11. Interests of individual Native Americans in trust or restricted lands, and the first \$2,000 per year of income received by individual Native American that is derived from a trust or restricted lands are not included in income. Amounts received under the Maine Indian Claims Settlement Act of 1980 are also excluded. In addition, all or a portion of the payments under the Alaska Native Claims Settlement Act, judgments of the Indian Claims Commission or U.S Court of Claims may be excluded from income. See HUD Handbook 4350.3 for details.
12. Payments received after January 1, 1989 from the Agent Orange Settlement Fund or any other fund established pursuant to the settlement in the Agent Orange product liability litigation are not included in income. M.D.L. No 236 (E.D.N.Y)
13. Any Earned Income Tax Credit to the extent it exceeds the tenant's income tax liability is not included in income. See IRC §32(j). For example, a tenant may have a tax liability of \$400, and an Earned Income Credit of \$700. The credit will not only eliminate that \$400 tax liability, but the tenant will receive a \$300 refund. The \$300 is not included in income. Alternatively, the tenant may receive payments directly from his/her employer during the year. These periodic payments are not included in income.
14. The value of any childcare provided or arranged for under the Child Care and Development Block Grant Act of 1990 (CCDBG) (42 U.S.C. 9858q) is not included in income. Participating families may either pay a reduced amount based on a sliding fee scale or they may receive a certificate for child care services. Note that funds received through CCDBG for providing childcare services are included in income.

Tenant Income Certification Effective Date

Once all sources of income and assets have been properly verified, owners or managers perform an income calculation using the applicant's tenant income certification to determine whether the applicant qualifies for IRC §42 housing.

The effective date of the tenant's income certification is the date the tenant actually moves into the unit. All adult members of the household should sign the certification. HUD Handbook 4350.3, 5-17B. If the certification is more than 120 days old, the tenant must provide a new certification. The income recertifications, *if required,* must be completed annually based on the anniversary of the effective date.³⁵

³⁵ *Tenants may be subject to income certifications for other programs which define the effective date differently. The notation or use of alternative "effective dates" for purposes of triggering an annual income recertification will not disqualify an annual income recertification for IRC §42 purposes. The IRS will rely on the source documents; i.e., the signature dates on the initial income certification and subsequent income recertifications (as needed for mixed-use projects).*

Example 1: Determining the Tenant Income Certification Effective Date

A potential household consisting of John and Jane Doe and their two children completed a rental application and income certification on April 12, 2004. The property manager completed the third party verifications and determined that the household was income eligible on April 21, 2004. John and Jane signed the rental lease on April 25th, and took possession of the unit on May 1, 2004.

The effective date of the tenant income certification is May 1, 2004. All subsequent tenant income recertifications must be performed within 120 days before May 1st of each subsequent year of the 15-year compliance period.

When additional adult individuals join the household, the effective day will remain the same until the unit is completely vacated.

Example 2: Effective Date After Move In of Additional Adult Member

Jane and her daughter were income qualified and moved into an LIHC unit on September 5, 2003. On March 15, 2004, Jane's widowed mother joined the household.

The tenant income certification continues to be based on the original certification date. All subsequent annual income recertifications will be completed within 120 days before September 5th each year until the household vacates the unit.

Signatures

Generally, all adult members of the household should sign the income certification before, or when, the household moves into the rental unit. However, there will be circumstances where obtaining the signatures is impractical. In these situations, the owner should document the reason for the delay in the tenant's file and secure the signature as soon as possible.

Example 1: Household Member is Serving in the Military

Mary, with her two children, applies for an LIHC unit and completes a tenant income certification. She discloses and includes the income her husband earns for military service in the Marines. He is currently on active duty and stationed overseas. The owner determines that Mary's household is income qualified for low-income housing

Mary signs the income certification two days before moving in. Because her husband is not available to sign the certification, the owner included documentation in the tenant file that he is in the military and stationed overseas. Mary's husband returns stateside five months later and signs the income certification as soon as he joins his family.

The owner is in compliance. The household's income is properly accounted for and the file sufficiently documents the reason why the husband could not timely sign the income certification. In this case, the file will also indicate that the signature was obtained within a reasonable time after his return.

Tenant Moves to Another Low-Income Unit

A household may move to another unit within a low-income project.

In the Same Building

When a household moves to a different unit within the building, the newly occupied unit adopts the status of the vacated unit.³⁶ Thus, if a current household, whose income exceeds the applicable income limitation moves from an over-income unit to a vacant unit in the same building, the newly occupied unit is treated as an over-income unit. The vacated unit assumes the status the newly occupied unit had immediately before it was occupied by the current resident.

*Example 1: Household in Over-Income Unit Transfers Within Building

An initially income-qualified household occupying a low-income unit in a mixed-use project was determined to have income in excess of 140 percent of the current AMGI at the time of the last annual income recertification. The household subsequently moved from Unit A, a 2-bedroom over-income unit to Unit B, a vacant 3-bedroom low-income unit.

Even though the units are not comparably sized, Unit A is now a low-income unit and Unit B is an over-income unit.*

In a Different Building

As noted in Rev. Rul. 2004-82, Q&A #8, a similar rule applies when a household whose income is no greater than 140% of the income limit (or 170% for deep rent skewed projects) moves to a low-income unit in a different building within the project during any year of the 15-year credit period.³⁷ The vacated unit assumes the status the newly occupied unit had immediately before it was occupied by the current resident.

Example 1: Household is First Occupant of Low-Income Unit

On May 31, 2004, of the first year of the credit period, an income qualified household moved into a new, never-occupied, low-income unit in Building A. On October 19, 2004, the household moved, *and the lease was transferred,* to a similar rent-restricted unit in Building B, which had never been occupied, and continued to occupy the unit until the end of the first credit year. The unit in Building A was not rented again until February 2005.

Only the unit the household actually occupies qualifies as a low-income unit.

- The unit in Building A would qualify for May, June, July, August and September. The unit would not qualify as a low-income unit in October, November, or December for purposes of computing the Applicable Fraction for the first year under IRC §42(f)(2). The unit will continue to be treated as a never occupied unit until a qualified household moves in.
- The unit in Building B is a qualified low-income unit for October, November, and December.

³⁶ See Treas. Reg. 1.42-15(d).

³⁷ See IRC §42(g)(1) and IRC §142(d)(4)(B).

*Households residing in 100% LIHC projects, where a household's current income is not known, can also transfer between buildings within the project.

Example 2: Household in 100% LIHC Project Transfers Between Buildings

On August 15, 2008, an income-qualified household moved into a low-income unit. The unit was part of a 100% LIHC multi-building project as identified by the owner on Form 8609, line 8b. The household was not required to complete annual income recertifications and, therefore, the household's current income was not known when, on January 15, 2010, the household requested a transfer to a low-income unit in another building within the project.

The household may transfer to a low-income unit in another building within the project even though the household's income is not known.*

Income Certifications Where Owner Acquires or Rehabilitates Existing Building

Income Qualifying Households Before the Beginning of the 10-Year Credit Period

Under Rev. Proc. 2003-82, a unit occupied before the beginning of the credit period will be considered a low-income unit at the beginning of the credit period, even if the household's income exceeds the income limit at the beginning of the first year of the credit period, if two conditions related to income qualifications are met, and the unit must be rent restricted.³⁸

For households occupying a unit at the time of acquisition³⁹ by the owner, the initial tenant income certification is completed within 120 days after⁴⁰ the date of acquisition using the income limits in effect on the day of acquisition. The effective date of the tenant income certification is the date of acquisition since there is no move-in date.

In the event that the household occupies a unit at the time of acquisition, but the tenant income certification is completed more than 120 after the date of acquisition, the household is treated as a new move-in. Owners use the income limits in effect at the time of the tenant income certification and the effective date is the date the last adult member of the household signed the certification, (this is an exception to the general rule for effective dates because there is no move-in date).

When the household moves into a unit after the building is acquired but before the beginning of the first year of the compliance period, the tenant income certification is completed using the income limits in effect at the time of the certification and the effective date is the date the household moves into the unit.

³⁸ Rev. Proc. 2003-82, 2003-2 C.B. 1097, provides a safe harbor under which, if certain conditions are met, a residential rental unit in an existing building acquired by a new owner or in rehabilitated building will be treated as a low-income unit even though the occupants' incomes exceed the income limit at the beginning of the building's 10-year credit period. In order to qualify, the household must have been income-qualified at the time the owner acquired the building or the date the household started occupying the unit, whichever is later. The owner must maintain documentation of the income qualification and the unit must be rent restricted. See chapter 10 for further discussion of the requirement for units to be rent-restricted.

³⁹ The date of acquisition is the date the building is acquired by purchase under IRC §179(d)(2).

⁴⁰ *Alternatively, if the new owner has access to the property before the acquisition date, tenant income certifications may be completed before the acquisition using the current income limits. The effective date is the date of acquisition.*

**Testing for
Purposes of the
Next Available
Unit Rule**

For purposes of Rev. Proc. 2003-82, the incomes of the individuals occupying a unit occupied before the beginning to the first credit year are first tested for purposes of the Next Available Unit Rule under IRC §42(g)(2)(D)(ii) and Treas. Reg. 1.42-15 at the beginning of the first year of the building's credit period.⁴¹

1. The test must be completed within 120 days before the beginning of the first year of the credit period.
2. The "test" consists of confirming with the household that sources and amounts of anticipated income included on the tenant income certification are still current. If additional sources or amounts of income are identified, the tenant income certification will be updated based on the household's documentation. It is not necessary to complete third party verifications.
3. If the household is over-income based on current income limits, the Next Available Unit Rule is applied.

If the effective date of the initial tenant income certification is 120 days or less before the required "test", it is not necessary to "test" for purposes of the Next Available Unit Rule because the time period for completing the initial tenant income certification and the time period for completing the "test" is the same. The annual tenant income recertification will be completed each year on the anniversary of the original tenant income certification's effective date.

Example 1: The Effective Date of Initial Tenant Income Certification is 120 Days or Less Before the Test Date

An owner purchased an existing building on September 1, 2004 and anticipated beginning the credit period on January 1, 2005. Household A occupied a unit at the time of the purchase and was determined to be income qualified on September 22, 2004. Because the household was determined to be income-qualified within 120 days of January 1, 2005, it is not necessary to "test" for purposes of the Next Available Unit Rule.

If the effective date of the original tenant income certification is more than 120 days before the required "test," the household's income must be tested within 120 days before the beginning of the first year of the credit period.

Example 2: The Effective Date of Original Tenant Income Certification is More Than 120 Days Before the Beginning of the First Year of the Credit Period

An owner purchased an existing building on March 1, 2004 and anticipated beginning the credit period on January 1, 2005. Household A, an income qualified household, moved into a rent-restricted unit on April 1, 2004. Because the household was determined to be income-qualified more than 120 days before the beginning of the credit period on January 1, 2005, the household's income must be tested no earlier than 120 days before January 1, 2005 to determine whether the Next Applicable Unit Rule should be applied.

⁴¹ See chapter 14 for detailed discussion of the Next Available Unit Rule.

***Previously
Income-
Qualified
Households***

*Beginning with allocations of credit after 1989, owners of LIHC buildings are required to enter into extended use agreements with the state agency allocating the credit. Owners make a long-term commitment to maintain the buildings as low-income housing for at least 30 years beginning with the first day of the 15-year compliance period.⁴² The owner must maintain the specified number of low-income units (Applicable Fraction) based on the income limit elected under IRC §42(g)(1).

Households determined to be income-qualified for purposes of the IRC §42 credit during the 15-year compliance period are concurrently income-qualified households for purposes of the +30-year extended use agreement. As a result, any household determined to be income qualified at the time of move-in for purpose of the extended use agreement is a qualified low-income household for any subsequent allocation of IRC §42 credit.

Example 1: Owner Receives Additional Credit for Rehabilitation

An owner received IRC §42 credits to construct new low-income housing. The owner placed the buildings in service in 1991 and started claiming credits the same year. The 15-year compliance period ended December 31, 2005. In 2007, the owner applied for and received an allocation of credit to rehabilitate the existing low-income buildings. The rehabilitation is completed and the owner starts claiming the credit in 2009.

On February 1, 2004, John and Mary are determined to be income-qualified and move into a low-income unit project. John and Mary timely complete their income recertification each year 2005 through 2008. The unit has always qualified as a low-income unit, except when the unit was not suitable for occupancy during the rehabilitation period.

The unit is a low-income unit on January 1, 2009, when the owner (a calendar year taxpayer) begins claiming the credit. If the unit was determined to be an over-income unit under IRC §42(g)(2)(D) at the time of the household's last income recertification in January of 2008, then the owner is subject to the Available Unit Rule. (See Chapter 14.)

NOTE: Similarly, vacant units previously occupied by income-qualified households continue to qualify as low-income units if the units are suitable for occupancy. However, the owner is subject to the Vacant Unit Rule. (See Chapter 15.)

Example 2: New Owner Receives Credit for Acquisition and Rehabilitation

Owner ABC received IRC §42 credits to construct new low-income housing. ABC placed the buildings in service in 1991 and started claiming credits the same year. The 15-year compliance period ended December 31, 2005. In 2006, ABC sold the project to XYZ, who simultaneously received an allocation of acquisition and rehabilitation credit. The rehabilitation was completed and XYZ started claiming the credit in 2008. From the time of acquisition until a new extended use agreement is recorded, XYZ is subject to

⁴² *See IRC §42(h)(6) and chapter 16 for complete discussion.*

the extended use agreement between ABC and the state agency.⁴³ On February 1, 2004, John and Mary are determined to be income-qualified and move into a low-income unit project. John and Mary timely complete their income recertification each year 2005 through 2007. The unit has always qualified as a low-income unit, except when the unit was not suitable for occupancy during the rehabilitation period.

Based on the 2007 annual income recertification, the unit is a low-income unit at the beginning of XYZ's credit period on January 1, 2008, when XYZ (a calendar year taxpayer) begins claiming the credit. XYZ should follow the procedures under Rev. Proc. 2003-82 to test income at the beginning of the credit period as described above.

NOTE: Vacant units previously occupied by income-qualified households are not low-income units on January 1, 2008. The owner must apply IRC §42(f)(2).*

Income Qualifying Households During First Year of the 10-Year Credit Period

Under IRC §42(f)(2), the applicable fraction for the first year of the credit period is computed based on a month-by-month accounting of units or floor space occupied by income-qualified households. In the case of buildings that were acquired and then rehabilitated, there are two separate allocations of credit documented on two Forms 8609; one for the acquisition credit and a separate allocation for the rehabilitation credit. However, the owner is not required to determine two applicable fractions. Under IRC §42(e)(4)(B), the applicable fraction for the substantial rehabilitation credit will be the same as the applicable fraction for the acquisition credit. Therefore, for purposes of computing the applicable fraction under IRC §42(f)(2), the following units are considered low-income units:

1. Units occupied before the beginning of the credit period, which are determined to be low-income unit at the beginning of the credit period under Rev. Proc. 2003-82.
2. Units initially occupied after the beginning of the credit period by newly certified income-qualified households (regardless of whether rehabilitation costs have been incurred for the unit).
3. Units occupied by income-qualified households that moved from other units within the project. The household's lease and tenant income certification (with effective date) move with the household. See the section above titled "Tenant Moves to Another Low-Income Unit" for complete discussion.

Units are *not* included in the numerator of computation of the applicable fraction if:

1. The unit is occupied by a nonqualified household;
2. The unit is vacant and was last occupied by a nonqualified household;

⁴³ *See IRC §42(h)(6)(B)(v)*

3. The unit is not suitable for occupancy under IRC §42(i)(3)(B)(ii). These units, including units being rehabilitated, are considered “out of compliance.”⁴⁴ The noncompliance is corrected when the unit is again suitable for occupancy. The unit’s character will be determined based on the household that occupied the unit immediately preceding the rehabilitation during the first year of the credit period. See #4 on the list above.

Example 1: Units Rehabilitated During the First Year of the Credit Period

An owner acquired a building with 10 units and determined that 6 of the units (1-6) were occupied by nonqualifying households at the beginning of the first year of the credit period on January 1, 2005. Four units (7-10) were occupied by income-qualified households. The nonqualifying households moved out and the owner rehabilitated the six vacant units. Five of the rehabilitated units (1-5) were rented to new households that moved into the units in August of 2005. The sixth rehabilitated unit (6) was rented in August to an existing tenant who transferred from unit 7, one of the four units qualifying on January 1, 2005

1. The owner may include units 1-5, the rehabilitated units occupied by new low-income tenants in the applicable fraction computation under IRC 42(f)(2) for August, September, October, November, and December of 2005
2. For the tenant who transferred between units within the building, the owner may include the unrehabilitated unit 7 that the tenant occupied from January through July in the computation of the applicable fractions for those months, but the unit is no longer a low-income unit when the household moves to the rehabilitated unit 6 in August; Unit 6 is a low-income unit for August through December.

Therefore, for purposes of computing the applicable fraction for August, 2005, there are three low-income units that have not been rehabilitated (units 8, 9, and 10) and six low-income units that have been rehabilitated (units 1-6). Unit 7 is not a low-income unit.

During September, unit 7 was rehabilitated and the tenant from unit 8 moved in; therefore, unit 8 is *now considered a vacant market-rate unit.* To expedite completion of the rehabilitation of the remaining units, the owner also temporarily located the households in 9 and 10 in off-site quarters (and paid all expenses) and started rehabilitation of units 8, 9, and 10. For purposes of determining the applicable fraction for September, units 1-7 are low-income units and units 9, and 10 are out of compliance low-income unit. *Unit 8 is a market-rate unit that is being rehabilitated in September.*

⁴⁴ *The state agency is not required to file Form 8823 to report noncompliance during the rehabilitation period.*

⁴⁵ *In the January 2007 revision of the Guide, Unit 8 was considered a low-income unit. The IRS will not challenge a taxpayer’s reliance on the January 2007 explanation for determining the status of a unit before January 1, 2010. *

The owner completed the rehabilitation of the final three units (8, 9, and 10) in October and moved the two temporarily displaced households back into units 9 and 10 during October 2005. *Unit 8 remains an unoccupied market rate unit through December.⁴⁵ For purposes of computing the applicable fraction for October, units 1-7, 9, and 10 are all low-income units. The same is true for November and December.*

The following chart summarized the status of each unit for each month during 2005. *The columns (left to right) represent the individual months and the rows (top to bottom) represent Units 1 through 10. The field where a row and column intersect indicates the unit's status as either "LIHC" for a low-income unit or is left blank if the unit is not a low-income unit.*

Unit	Jan	Feb	Mar	Apr	May	June	July	Aug	Sept	Oct	Nov	Dec
1								LIHC	LIHC	LIHC	LIHC	LIHC
2								LIHC	LIHC	LIHC	LIHC	LIHC
3								LIHC	LIHC	LIHC	LIHC	LIHC
4								LIHC	LIHC	LIHC	LIHC	LIHC
5								LIHC	LIHC	LIHC	LIHC	LIHC
6								LIHC	LIHC	LIHC	LIHC	LIHC
7	LIHC		LIHC	LIHC	LIHC	LIHC						
8	LIHC											
9	LIHC		LIHC	LIHC	LIHC							
10	LIHC		LIHC	LIHC	LIHC							

Documentation Requirements

For a unit to be included as a low-income unit, documentation of the household's initial eligibility must be on file with the owner. Under IRC §6001, every taxpayer is required to maintain records sufficiently detailed to prepare a proper tax return. This requires the maintenance of such permanent books and records sufficient to establish the amounts of gross income, deductions, *credits*, or other matters to be shown on the taxpayer's return. This requirement extends to the preparation and maintenance of tenant files sufficiently documented to support household eligibility for purposes of claiming the low-income housing credit under IRC §42.

A tenant income certification and supporting documentation are not sufficient unless, at a minimum, the following documents are included:

1. Application/Income and Asset Questionnaire - A document completed by the household that the owner uses to gather information relevant to establishing all aspects of eligibility including, but not limited to, household composition, income, income from assets, and student status.
2. Verification of Income and Assets - All sources of income and assets must be verified to establish move-in eligibility.⁴⁶ Each tenant file must contain an annual statement of income, household composition, and student status.

The preferred verification method is through third parties, and such verifications must be no older than 120 days before the effective date of the Tenant Income Certification. *Verification may be written documentation (mail), oral (telephone), or electronic (facsimile, e-mail, or Internet).* Where applicable, there should be further evidence to support the third party verifications; e.g., a copy of a divorce decree showing award of maintenance or child support, a realtor's statement of market value for a home, a self-employed tenant's tax return, etc. When third party verification has been *delayed or* attempted, but is not possible, documentation may be by check stubs, W-2's, bank statements, etc. Self-certification *(notarized statement or signed affidavit)* may be accepted if third party verification or other documentation cannot be obtained. Documentation of attempts to obtain verification, however, must be kept on file.

3. Student Status - Depending upon the student status of each household member, student verification may be required. (See chapter 17 for more information.)
4. Tenant Income Certification – Documents must be signed by all the adult members of a household prior to move-in and at the time of the annual recertification, and must state the anticipated annual gross income of the household.

Sufficient But Imperfect Documentation

If eligibility documentation is imperfect, yet sufficient for the monitoring agency to make a reasonable determination that a household is eligible, the owner should be advised of the imperfections and the need to implement procedures ensuring that similar imperfections do not occur in the future. Imperfections are not of a nature that would cause the unit to be considered out of compliance and will not result in reportable noncompliance.

Use of Standardized Forms

The compliance monitoring regulations under Treas. Reg. §1.42-5 establish the minimum monitoring requirements. State agencies can determine how documents are maintained and may mandate the use of standardized forms to document an owner's compliance with the requirements under Treas. Reg. §1.42-5.

In Compliance

In order to establish a unit as a qualified housing tax credit unit, the household's Gross Annual Household Income must be at or below the elected area median income (AMGI) limit or national nonmetropolitan median gross income (NNMGI) limit when applicable, adjusted for family size. Household income is calculated in a manner consistent with the

⁴⁶ Rev. Proc. 94-65, 1994-2 C.B. 798, allows building managers to obtain a tenant's signed, sworn statement if the total combined cash value of household assets is less than \$5,000. Some states have not implemented this procedure and will require third party verification. The states that allow this have an appropriate form.

determination of annual income under section 8 of the United States Housing Act of 1937. Therefore, the definitions of income of individuals and AMGI for purposes of IRC §42(g)(1) include items of income that are not included in a taxpayer's gross income for purposes of computing a federal tax liability.

Documentation of the household's initial eligibility must be on file with the owner. The initial tenant income certification must be completed and signed by all the tenants on or before the move-in date.

Example 1: Unrelated Parties Sharing an Apartment

Sally and Jane are unrelated individuals who want to rent a two-bedroom apartment in an LIHC building. Sally and Jane's combined income does not exceed 60% of the AMGI for a two-individual family.

In this case, Sally and Jane are qualified tenants for low-income credit housing. For purposes of computing the Gross Annual Household Income, the combined income of all the occupants of an apartment, whether or not legally related, is compared to the median family income for a household with the same number of members.

State agencies may determine that, even though the documentation at the time a certification was performed was insufficient, sufficient documentation was subsequently obtained by the owner *before* the state agency's notification of a compliance review, which allowed the monitoring agency to make a reasonable determination that the unit was in compliance. Such self-corrected documentation should not be reported to the IRS as noncompliance. The owner has demonstrated due diligence and reasonable attempts to maintain sufficient documentation of tenant eligibility.

Example 2: Failure to Obtain Third Party Verification

An owner initially failed to verify or include documentation of court-ordered child support when the household moved in. The oversight was identified nine months later when the owner's management company conducted a quality review of the file. The management company immediately corrected the deficiency by obtaining a copy of the court order for the child support. When the amount of child support was added to the move-in income, the annual income did not exceed move-in eligibility. The unit is in compliance with IRC §42 requirements.

Example 3: Correction After Notification of Upcoming Compliance Review

Unit A in an LIHC building went out of compliance on January 15, 2004, when a household with income exceeding the limit moved in. The owner was notified on March 15, 2004, that the state agency would be conducting a tenant file review on May 1, 2004. The owner realized the problem while preparing for the review and paid the moving costs for the over-income household to move out immediately. A new income-qualified household moved into Unit A on April 13, 2004.

The state agency selected Unit A as part of the 20% sample and reviewed the new tenant's income certification. Because the effective date of this certification was after the date of the notification of the upcoming review, the state agency requested the file for the previous tenant and determined that Unit A was out of compliance from January 15 to April 13, 2004.

Example 4: Tenant Income Increases After Move In

John and Mary are newly married, in their early 20's, and have moved to a new city where John has accepted a job. The couple is income-qualified based on John's anticipated salary for the next 12 months. Three weeks after they move in, Mary starts working. If her wages are added to the tenant income certification, the couple's income exceeds the limit.

There is no noncompliance if the state agency determines that the owner used due diligence in accepting John and Mary as a qualified low-income household based on their initial tenant income certification. For example, the owner can demonstrate that due diligence was exercised by asking whether Mary intended to seek employment *or was sporadically employed during the prior year.* However, the next available unit rule may apply. See chapter 14.

By itself, the fact that a tenant's actual income exceeds the anticipated income identified during the income certification is not a reportable noncompliance event (hindsight is always perfect). However, the state agency should consider expanding the sample size if multiple instances are identified. Collectively, multiple errors are indicative of poor internal control and increased risk of noncompliance.

The tenant income certification should be based on the best information available at the time of the certification. It represents the income the household anticipates it will receive in the 12-month period *following* the effective date of certification of income. If information is available on changes expected to occur during the year, that information should be used to most accurately determine the anticipated income from all known sources during the year. *If the household reports little or zero income, or sporadic income, owners may use estimates based on actual income earned or received during the twelve month period immediately preceding the certification.* Owners should use due diligence by asking follow-up questions when the income certification process reveals unusual circumstances suggesting additional sources of income.

Out of Compliance

Units are considered out of compliance as of the date an ineligible household moves into a unit. A unit will also be considered out of compliance if the initial tenant income certification is inaccurate, documentation of initial eligibility is insufficient, or no initial tenant file is on record.⁴⁷

⁴⁷ A determination by the IRS (during an examination) that the taxpayer has not maintained adequate books and records may result in the issuance of an Inadequate Records Notice. The notice informs taxpayers that their recordkeeping practices are insufficient and must be improved to meet the requirements of the law. The issuance of an Inadequate Records Notice may result in a follow-up examination.

Example 1: Specific Source of Income Omitted

Annual Income was not properly calculated. The manager/owner did not include a source of income, such as a raise, overtime, or bonus. When reviewed, a correct calculation indicates that the household was not income eligible at move-in.

Example 2: Household Incorrectly Determined to be Eligible

The owner calculated annual household income correctly, but the household is over the appropriate income limit at move-in. For example, the owner may have used the income limit for the 40/60 minimum set-aside when the income limit for the 20/50 minimum set-aside income limit was required, or the wrong county AMGI, or the income limits used were not in effect as of the date of the tenant income certification.

Example 3: Unrelated Parties Sharing an Apartment

Tom and Jack are unrelated individuals who want to rent a two-bedroom apartment in an LIHC building. Tom and Jack individually have incomes that do not exceed 60% of AMGI for one individual. However, Tom's and Jack's combined income exceeds 60% of the AMGI for a two-individual family.

In this case, Tom and Jack do not qualify for LIHC housing. For purposes of computing the Gross Annual Household Income, the combined income of all the occupants of an apartment, whether or not legally related, is compared to the median family income for a household with the same number of members.

Example 4: No Initial Tenant Income Certification on File

A household moves into a unit that the owner wishes to include as an LIHC unit. However, the owner does not provide documentation of initial eligibility at the time the state agency reviews the tenant's file. The owner cannot substantiate that the unit qualifies for the LIHC.

Example 5: No Initial Tenant Income Certification on File for New Member of Household

An income qualified household moved into an LIHC unit. Six month later, an adult friend moved into the unit with the household, but no initial tenant income certification was completed for the additional member of the household.

Example 6: Initial Tenant Income Certification Performed After Move-In (Late Certification)

A household moved into a unit that the owner wanted to include as a low-income unit. However, the certification of income eligibility, including the

third party verification, was not performed until after the household moved in.

Example 7: Insufficient Documentation of Initial Eligibility

A household moves into a unit that the owner wishes to include as a low-income unit. Income eligibility was not properly documented. The state agency could not reasonably determine that the household was income qualified. The following are possible documentation noncompliance issues:

- a. Application/questionnaire is not sufficiently detailed to disclose all sources of income and/or assets,
- b. Not all sources of income are verified,
- c. Not all sources of assets are verified,
- d. Verifications are insufficient,
- e. Not all adult household members' income and/or assets are disclosed and included;
- f. Tenant income certification form is not prepared, signed and/or dated; and
- g. Other state-required forms designed to document compliance with IRC §42 are not in file.

Back in Compliance

Units are back in compliance when it is determined that an income-qualified household occupies the unit. Evidence of corrected noncompliance includes copies of certification paperwork such as the tenant's application, income and asset questionnaire, third party verifications, and tenant income certification.

Insufficient Documentation

In the event that income eligibility was not properly documented and the state agency cannot reasonably determine that the household is eligible, the noncompliance can be corrected in either of two ways:

1. A new certification can be performed using current income and asset sources and current income limits. Assuming the household is eligible, the unit would be out of compliance on the date of move in and back in compliance on the date the new certification signed (Form 8823 should be filed); or
2. A retroactive certification can be performed which completely and clearly documents the sources of income and assets that were in place at the time the *initial certification* should have been effective, and applies income limits that were in effect on that date. Assuming the owner can document that the household was income eligible at the time of move in, the unit should not be considered out of compliance. The owner has clarified the noncompliance; Form 8823 should not be filed.

Evidence of corrected noncompliance may include a copy of the full certification, including application, third party verifications, and/or the tenant income certification.

Income Ineligible Households

The household may be income certified as if it were a new move-in. If the household is eligible under the applicable move-in income limit in place on the date of the new certification, then the unit would be considered back in compliance.

Example 1: Ineligible Household Occupies LIHC Unit

The household was over the appropriate income limit at move-in on June 1, 2002. The error was discovered during the state agency's review on April 3, 2003.

The owner may treat the household as a new tenant and complete a new income certification using the income limits in effect on April 3, 2003. If the household is qualified, the noncompliance is corrected. The unit is out of compliance from June 1, 2002 until April 3, 2003. If, upon certification, the household is not income-eligible, the unit is considered back in compliance when a new income-qualified household moves into the unit. In either scenario, a Form 8823 noting the noncompliance must be filed.

Initial Tenant Income Certification is Late

If the initial certification is late, the unit is considered out of compliance as of the date the tenant moved into the LIHC unit and back in compliance on the date the completed income certification, indicating the household is income qualified, is signed by all the tenants.

Example 1: Initial Tenant Income Certification Performed After Move-In (Late Certification)

A household moved into an LIHC unit on August 4, 2003. However, certification of eligibility, including the third party verification, was not completed until September 15, 2004. If the tenant income certification meets all the requirements, the unit is considered in compliance beginning on September 15, 2004.

Note: Noncompliance with the initial income certification requirements that is identified and corrected by the owner retroactive to move-in and *prior to notification* of the compliance review by the state agency need not be reported; i.e., the owner has demonstrated due diligence by addressing noncompliance issues independently. See chapter 3.

References

1. IRC § 42(g)(1)
2. Treas. Reg. 1.42-5(b)(1)(vii) states that “[t]enant income is calculated in a manner consistent with the determination of annual income under Section 8 of the U.S. Housing Act of 1937.”
3. *HUD Handbook 4350.3 as revised June 2007 is the authority for further information on calculation of annual income. HUD publishes updated 50% Median Family Income limits annually. Other income limit schedules such as the 60% limits are based on an extrapolation of the 50% limits.*
4. Rev. Rul. 89-24, 1989-1 C.B. 24

5. Rev. Rul. 90-89, 1990-2 C.B. 8
6. Rev. Rul. 91-38, 1991-2 C.B. 3
7. Rev. Rul. 2004-82, 2004-2 C.B. 350
8. Rev. Proc. 94-65, 1994-2 CB 798
9. Rev. Proc. 2004-38, 2004-2 C.B. 10, which supersedes Rev. Proc. 94-64, 1994-2 C.B. 797
10. Rev. Proc 2003-82, 2003-2 C.B. 1097
11. Notice 88-80, 1988-2 C.B. 396
12. Notice 2008-79, 2008-40, I.R.B. 815

Exhibit 4-1
CCA 2009090416224806

ID: CCA_2009090416224806

Office: CC:PSI:5

UILC: 42.00-00

From: [...]

Sent: Friday, September 04, 2009 4:22:51 PM

To: [...]

Cc: [...]; [...]

Subject: Increases in Family Size under §42(g)(2)(D)(ii)

This e-mail responds to your request for assistance regarding increases in family size under §42(g)(2)(D). You have asked on behalf of revenue agents and state housing agencies whether addition of a new member to an existing low-income household requires the household to be treated as a new household for purposes of §42(g).

Chapter 4 of the Guide for Completing Form 8823 (revised January 2007) on pages 4-3 & 4-4 provides that the addition of new member(s) to an existing low-income household requires the income certification for the new member of the household. The new member's income is added to the income disclosed on the existing household's tenant-income certification. A household may continue to add members as long as at least one member of the original low-income household continues to live in the unit. Once all the original tenants have moved out of the unit, the remaining tenants must be certified as a new income-qualified household unless the remaining tenants were income qualified at the time they moved into the unit. The household continues to be income qualified and the income of the new member is taken into consideration for purposes of the available-unit rule under §42(g)(2)(D). If a state agency determines that the tenants manipulated the income limitation requirements, then the unit should not be treated as a low-income unit as of the date the household initially occupied the unit.

Section 42(g)(2)(D)(i) states that, except as provided in §42(g)(2)(D)(ii), notwithstanding an increase in the income of the occupants of a low-income unit above the income limitation, such unit shall continue to be treated as a low-income unit if the income of such occupants initially met such income limitation and such unit continues to be rent-restricted.

Section 42(g)(2)(D)(ii) provides that if the income of the occupants of the unit increases above 140% of the income limitation under §42(g)(1), §42(g)(2)(D)(i) shall cease to apply to any such unit if any residential rental unit in the building (of a size comparable to, or smaller than, such unit) is occupied by a new resident whose income exceeds such income limitation.

The legislative history of §42 provides that, for purposes of the available unit rule, if the tenant's income increases to a level more than 40 percent above the otherwise applicable ceiling (or if the tenant's family size decreases so that a lower maximum family income applies to the tenant) that tenant is no longer counted in determining whether the project satisfies the set-aside requirement. No penalty is assessed in such an event, however, provided that each residential rental unit that becomes vacant (of comparable or smaller size to the units no longer satisfying the applicable income requirement) is rented to tenants satisfying the qualifying income until the project is again in compliance. Joint Committee on Taxation Staff, General Explanation of the Tax Reform Act of 1986, 99th Cong., 2d Sess. 162 (1987).

The above cited legislative history demonstrates that decreases in family size are subject to the available-unit rule in §42(g)(2)(D)(ii). We see no reason why increases in family size should not be subject to the same rule. For example, if an existing low-income household's income increases above 140% of the applicable income limitation, then the unit continues to be treated as a low-income unit if the available-unit rule under §42(g)(2)(D)(ii) is met. Yet, if the addition of a new member to an existing low-income household results in the household being treated as a new household, then any increases in income above the applicable income limitation, no matter how small, would result in the unit not being a low-income unit. Provided the household is not manipulating the income limitation requirements, we see no difference between increased household income and increased household income resulting from the addition of a new member to the low-income household.

Accordingly, we continue to believe that rule for increases in family size in the Guide for Completing Form 8823 is correct. The new member of the existing low-income household must complete an initial income certification and provide third party verification regardless of whether §142(d)(3)(A), as amended by section 3010(a) of the Housing Assistance Tax Act of 2008, applies to the project.