



## CALIFORNIA TAX CREDIT ALLOCATION COMMITTEE

---

915 Capitol Mall, Suite 485  
Sacramento, CA 95814  
p (916) 654-6340  
f (916) 654-6033  
www.treasurer.ca.gov/ctcac

### MEMBERS

FIONA MA, CPA, CHAIR  
State Treasurer

BETTY YEE  
State Controller

JOE STEPHENSHAW  
Director of Finance

GUSTAVO VELASQUEZ  
Director of HCD

TIENA JOHNSON HALL  
Executive Director of CalHFA

DATE: November 10, 2022

EXECUTIVE DIRECTOR  
NANCEE ROBLES

TO: Owners of Low Income Housing Tax Credit (LIHTC) Projects

FROM: California Tax Credit Allocation Committee

RE: Final Average Income Targeting (AIT) Guidance

On October 7, 2022, the IRS released the [Section 42, Low Income Housing Average Income Test Regulations](#). These regulations constitute the final guidance from the IRS for the Average Income Test (AIT) set-aside for low-income housing. CTCAC will adhere to the final guidance and will continue to require more restrictive standards (as allowed for in the final regulation) on some aspects as currently noted in the current State Regulations (Qualified Allocation Plan or QAP).

**Background:** In 2018, Congress enacted the Consolidated Appropriations Act of 2018, which added a third minimum set-aside of Average Income Test (AIT) to the existing 40/60 and 20/50 set-asides. The AIT allows for unit income ranges between 20% - 80% of AMI if the overall average of the units at the property does not exceed 60% of AMI. CTCAC released guidance in March of 2018 and written into the State QAP effective May 16, 2018, that projects electing the AIT set-aside must adhere to a deeper targeted requirement. The requirements are:

- For projects seeking a competitive allocation of credits (9%) – the overall average of the project may not exceed 50% of AMI, rather than the 60% allowed in the federal legislation. This requirement keeps reporting requirements consistent at the State level with those competitive projects that choose a 40/60 or 20/50 set-aside.
- For projects seeking a non-competitive allocation of credits (4%) - the overall average of the project may not exceed 59% of AMI, rather than the 60% allowed in the federal legislation. In 2020, this State regulation was modified to the IRS requirement of 60%.

### Final Regulation Guidance:

**Minimum Requirements of the Average Income Test (AIT) set-aside** – a project meets the minimum requirement of AIT if 40% or more of the residential units in the project are both rent restricted and occupied by tenants whose income does not exceed an average of 60% of Area

Median Gross Income (AMGI). Units may be designated at 20%, 30%, 40%, 50%, 60%, 70%, or 80% of AMGI.

**Irrevocable Election** - Under Section 42(g), once a taxpayer elects a set-aside, the election is irrevocable. If a taxpayer previously elected to use a 20/50 or 40/60 set-aside, they may not subsequently elect to use AIT.

**Designated Units** – Section 42(g)(1)(C)(ii)(I) requires the taxpayer to designate each unit's imputed income limitation to determine the overall average of the property. The final regulation revises the timing of the designation from the end of the 1<sup>st</sup> year of the credit period to when a unit is first occupied as a low-income unit.

The IRS Final guidance does provide guidance for changing unit designations under certain circumstances:

1. In accordance with any procedures established by the IRS in forms, instructions, or published guidance
2. In accordance with an Agency's (CTCAC's) publicly available written procedures available to all AIT projects
3. To enhance protections of ADA, Fair Housing, VAWA, or any other State, Federal, or local law or program that protects tenants and that is identified by either the IRS or Agency (CTCAC). These protections do not necessarily have to have a specific connection to Section 42
4. To allow an existing qualified resident to transfer to a different unit within the project and keep the same income limitation and gross rent
5. To restore the required average income limitation to identify the qualified group used in conjunction with satisfying the minimum set-aside or applicable fraction

CTCAC will require that the initial designations determined at Placed in Service and noted in the Regulatory Agreement for the property, remain throughout the full 55 year compliance period. Owners may swap the status of units as needed and described above, but the number of units designated at each of the percentages (20% - 80%) must remain as noted in the Regulatory Agreement.

**Next Available Unit Rule (NAUR)** – For AIT units that are designated at 20% - 60%, the NAUR determination is calculated at 140% of the current 60% AMGI. For AIT units that are designated at 70% or 80%, the calculation is based on 140% of the current AMGI for that designation. The NAUR states that if an existing tax credit household exceeds the current AMGI by 140% or more, then the next unit of equal or smaller size must be rented to a qualified household.

For AIT projects, the taxpayer must limit the designation on the next unit in a way that will not cause the average of the project to exceed 60% of AMGI. In the case of AIT projects with multiple units exceeding the 140%, the IRS clarified that there is not a specific order in which units must be occupied, however, the order in which the groups are occupied may affect the qualified group used for determining the applicable fraction.

**Applicable Fraction** – Under the final regulations, the group of units used to determine the applicable fraction follows the same approach as determining the AIT set-aside. If a unit designated at a higher percentage causes the average of an otherwise qualified group to

exceed 60% of AMGI, that unit must be excluded from the applicable fraction calculation. If a unit loses low-income status, it may impact the other units within the group, and the taxpayer may have to exclude one or more additional units to retain an average that does not exceed 60% of AMGI.

Additionally, the final regulations require that the taxpayer separately identify the units used to satisfy the AIT set-aside and the qualified group of units noted for determining the applicable fraction. These should be documented in the taxpayer's books and records and communicated to CTCAC annually.

**Required Reporting** – Taxpayers are required to report specific information to CTCAC and maintain detailed records establishing the accuracy of the project's set-aside, applicable fraction, and compliance with Section 42 regulations. Currently CTCAC requires the Annual Owner Certification package be completed by March for the previous year. Starting in 2023, CTCAC will be adding an additional informational report for projects that have elected an AIT set-aside to comply with the tracking requirements of the IRS final regulations.

**Applicability Date** – The final regulations apply to taxable years beginning after December 31, 2022. For taxable years prior to the implementation of the final regulations, taxpayers may rely on the interpretation of the Statute by the allocating agency (CTCAC) for those years to which the regulations did not apply.

CTCAC staff thank you for your patience and understanding as we work toward meeting our LIHTC obligations. Changes to stated policies or procedures on this memo may be revised as the subject matter changes or CTCAC receives notification from IRS on any regulation changes or updates to the program. CTCAC looks forward to continued success in our working relationships with owners and management agents.

If you have any question regarding the policies or information noted above, you may contact the following staff:

Elizabeth Gutierrez-Ramos, Senior Compliance Program Manager  
[Elizabeth.gutierrez@treasurer.ca.gov](mailto:Elizabeth.gutierrez@treasurer.ca.gov)

Shannon Nardinelli, Senior Compliance Program Manager  
[Shannon.nardinelli@treasurer.ca.gov](mailto:Shannon.nardinelli@treasurer.ca.gov)

Or by phone at: 916-654-6340.