Income Averaging – Creating More Housing Now

With the goal of working towards the creation of industry standards, Dominium is proud to share what we have learned about **income averaging** through discussions with affordable housing experts in a series of topic-based correspondence that are meant to be shared with all interested industry professionals. We hope that through the sharing of this content, we can encourage the industry to work together to create widely accepted practices of how to utilize income averaging in a way that is both consistent and marketable.

Article 5: The Grey Areas of Income Averaging

Hi everyone, Jen Brewerton here, Vice President of Compliance at Dominium. In **last week's article**, we highlighted how creating flexibility around income averaging will empower the industry to adapt to future IRS guidance, shifting markets and to better serve our residents.

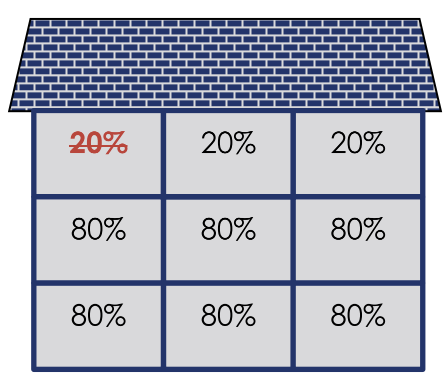
This week and in weeks to come, we will discuss a "grey area" relevant to income averaging: the industry is grappling with pending IRS guidance.

What Happens When a Unit Goes Out of Compliance?

The Consolidated Appropriations Act of 2018, also known as the Omnibus Spending Bill, provided us with the ability to elect income averaging on any new 8609 executed after March of 2018. Unfortunately, the bill did not include much guidance, leaving developers with a few questions. One of the biggest questions is, "what happens if a unit falls out of compliance, and the property average goes over 60 percent?"

For example, the following building/project has a 100 percent Applicable Fraction, has nine units, of equal size, with an average affordability of exactly 60 percent. If one of the 20 percent units is found to be out of compliance, the project average **would increase to 65 percent**:

Project Average-Before
20%
20%
20%
80%
80%
80%
80%
80%
80%
60%



Project Average-After
~~20%~~
20%
20%
80%
80%
80%
80%
80%
80%
65%

Does this project fail the minimum set aside test? No! (**See Dominium Article #1 here**)

While the project does meet its minimum set aside (so you can claim credits), the owner has failed to meet the building's 100 percent Applicable Fraction (so the owner might lose some credits).

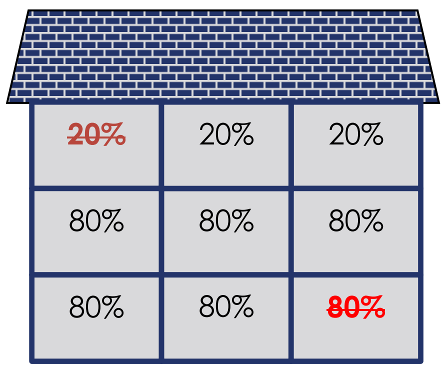
What happens now that the Applicable Fraction is not met?

The short answer is the same thing that has always happened - Tax Credits cannot be claimed on the units that are out of compliance. The grey area is calculating exactly how many units are out of compliance. Two frequently discussed options are:

1. The owner could lose credits on the one unit; or,

2. The owner could lose credits on multiple units until the building's average is at or below 60 percent. For example, in the previous example, one 20 percent unit went out of compliance, making the building's average to be 65 percent. Below, to correct the building average, we remove an 80 percent unit from the applicable fraction, potentially meaning a loss of credits on two units:

Project Average-Before	Project Average-After
20%	~~20%~~
20%	20%
20%	20%
80%	80%
80%	80%
80%	80%
80%	80%
80%	80%
80%	~~80%~~
60%	**62.9%**

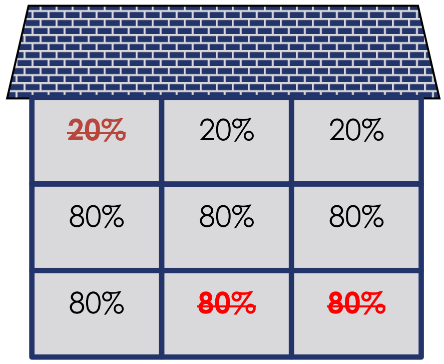


With a 62.9 percent average, we must remove more units.

Below, to correct the building average and get below 60 percent, we remove two 80 percent units from the applicable fraction, potentially meaning a loss of credits on three units:

Project Average-Before	Project Average-After
20%	~~20%~~
20%	20%
20%	20%
80%	80%
80%	80%
80%	80%
80%	80%
80%	~~80%~~
80%	~~80%~~

60%



60%

We have a building that averages 60 percent.

There are some important factors to point out here:

1. We don't know if either scenario is correct, in the meantime, we will defer to state agency policy, and hope for IRS guidance (which could even come out of potential IRS Private Letter Rulings).

2. We do know, from previous IRS guidance, that if the owner discovered the non-compliance and self-corrected prior to a state agency sending "**bright-line notice**," a state agency should not issue IRS Form 8823.

3. The rules of claiming credits on units that are out of compliance and the ability to correct those mistakes are the same as they were prior to income averaging. As long as owners of LIHTC properties exercise due diligence, the risk for credit loss remains very low.

The take away: Until we get IRS guidance, owners of income averaged buildings should exercise due diligence and create strong policies to maintain compliance.

Please feel free to share this information within or outside the industry so we can continue to help make income averaging as effective as possible on a national scale. To read additional articles on income averaging from our industry experts, please visit the **Dominium Newsroom**. If this is a topic you would like to discuss, please do not hesitate to reach out at **incomeaveraging@dominiuminc.com**.

Thank you!

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