Back to Basics 2: Income Limits

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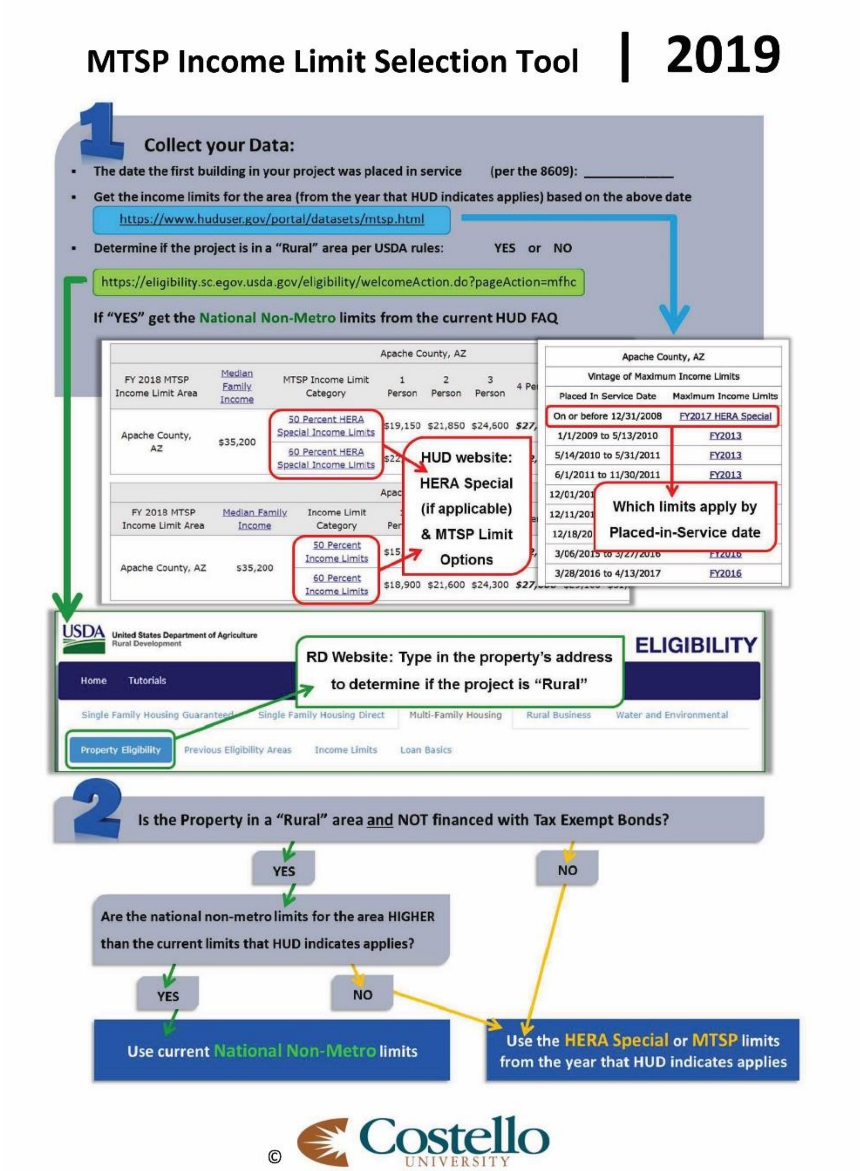
In this series, we've covered the basics of tax credit compliance and how to research answers to questions tax-credit professionals have in their daily practice. In this Back to Basics article, the focus will be on income limits — which determine household eligibility for units as well as rents — for tax-credit properties.

Originally, the tax-credit program shared the Department of Housing and Urban Development's (HUD) Section 8 income limits. However, the Housing and Economic Recovery Act of 2008 (HERA) created a new process to determine income limits for *tax-credit* and *tax-exempt bond* properties.

HUD still publishes both limits, so to differentiate them, HUD dubbed the new limits Multi-family Tax Subsidy Program (MTSP) limits. Once the data are secured from HUD, there are a few options for tax-credit properties to understand to select the correct limits for a specific property. These commonly asked questions provide a good framework. The infographic below may also prove useful.



MTSP Program Implementation Dates

The tax-credit program has a provision found in Rev. Rul. 94-57 that an owner may rely on last year's income limits published by HUD until 45 days after HUD releases the new limits or HUD's effective date for those limits, whichever is later. However, because of the tax-credit income limit "hold harmless" provision discussed below, this 45-day period only matters in actual practice to a limited number of properties that have a first building placed in service *during* the 45-day period following publication of the new limits. IRS guidance is that the owner may select whichever set of limits provides the best advantage if a project places in service during this period and "hold harmless" to those limits going forward.

Common Questions

Question: The income limits went down for the area. What happens?

Answer: The tax-credit law changed with HERA. One new provision was that, starting in 2009, the limits that a specific tax-credit property uses do not have to go down from one year to the next, starting when the first building in a project places in service. This principle is referred to as "hold harmless." For example, assume that the first building in a project was placed in service in 2016, and limits went down in 2017 and again in 2018. The 2016 income (and rent) limits should be used for all those years. They will continue to be used until the published limits exceed the 2016 limits. At that time, the owner will use the new limits and will "hold harmless" to the new limits.

Quick test - A prior year's MTSP limit may be used if:

1. The published income limits for the project's area have gone down from a prior year, and
2. The project had at least one building that was in service during the applicable prior year.

Question: Are "HERA Special" or rural limits an option for my property?

Answer: HERA created the "hold harmless" provision discussed in the last question. It also created additional options for certain properties that face special challenges:

- "HERA Special" for certain older properties
- Rural national non-metropolitan average limits for rural projects with exceptionally low published income limits

The limit to select is based on a few simple factors. The following "quick tests" will help determine if the special limits apply.

Quick test - "HERA Special" limits may be used if:

1. HUD lists this option for the property's area.
2. At least one building in the project was placed in service in 2008 or earlier.

Quick test - "National non-metro" limits may be used if:

1. The project is not funded with tax-exempt bonds.
2. The project is in an area determined by the Department of Agriculture (USDA) to be "rural" and the published MTSP limits for the area are lower than the national non-metro limits.

Note: Use the USDA website to determine if a project is rural and the HUD FAQ for a list of national non-metro limits. (For 2017, it was part of the answer to FAQ No. 13.) Also note that HUD only publishes the 50% limits in the FAQ. The 60% limits for 40-60 minimum set-aside properties need to be calculated from the 50% limits; simply multiply the supplied 50% limits by 1.2.

Income Limits and the Income Average Test

The 2018 Omnibus Tax Act created a new minimum set-aside, the Income Average Test. A full discussion of this new provision is beyond the scope of this article.

However, one aspect of the Income Average Test is that new tax-credit properties can assign up to seven designations (20% - 80% MTSP, in even increments of 10%) to units. People who move into these units must be below the designated income limit. Rents will be calculated based on these income limits as usual for the tax-credit program.

Based on Rev. Rul. 89-24

Designation	Multiply the 50% (very low) income limit by:
20	40%
30	60%
40	80%
50	100%
60	120%
70	140%
80	160%

How are these new designations calculated? Rev. Rul. 89-24 already established how to calculate 60% and 40% designations based on HUD 50% (very low) income limits. Based on this regulated model, this chart provides a basis for income limit calculations.

Bonus Question: Do MTSP limits apply to the HOME program?

Answer: No, HOME income and rent limits are not the same as the MTSP limits, are published later, and are subject to HOME-specific regulations. "Hold harmless" provisions do not apply to HOME units for HOME income-limit purposes. This is true even if the property is also a tax-credit property.

The HERA income limits added some complexity to the selection of limits, but each new option it created assists tax-credit properties with stable income and rent limits. Learning to select the correct limits is a vital skill for tax-credit professionals.

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