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[4830-01-p]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 10036]

RIN 1545-BQ47

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

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and removal of temporary regulations.

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

DATES: *Effective date*: These regulations are effective on **[INSERT DATE OF PUBLICATION IN THE *FEDERAL REGISTER*]**.

Applicability date: For dates of applicability, see §1.42-19(f).

FOR FURTHER INFORMATION CONTACT: Waheed Olayan at (202) 317-4137 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Authority

This document contains amendments to the Income Tax Regulations (26 CFR part 1) under section 42 of the Internal Revenue Code (Code) relating to recordkeeping and reporting requirements for the average income test for purposes of the low-income

housing credit (final regulations). The final regulations are issued under the authority granted to the Secretary of the Treasury or the Secretary's delegate (Secretary) in sections 42(n) and 7805(a) of the Code.

Section 42(n) provides, in part, "The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of [section 42] …"

Section 7805(a) provides, "[T]he Secretary shall prescribe all needful rules and regulations for the enforcement of [the Code], including all rules and regulations as may be necessary by reason of any alteration of law in relation to internal revenue."

Background

The Tax Reform Act of 1986, Public Law No. 99-514, 100 Stat. 2085 (1986 Act) created the low-income housing credit under section 42. Section 42(a) provides that the amount of the low-income housing credit for any taxable year in the credit period is an amount equal to the applicable percentage (effectively, a credit rate) of the qualified basis of each qualified low-income building.

Section 42(c)(1)(A) provides that the "qualified basis" of any qualified low-income building for any taxable year is an amount equal to: (i) the applicable fraction, determined as of the close of the taxable year, multiplied by (ii) the eligible basis of the building (determined under section 42(d)).

Section 42(c)(1)(B) defines the term "applicable fraction" as the smaller of the unit fraction or floor space fraction. The unit fraction is the number of low-income units in the building divided by the number of residential rental units (whether or not occupied) in the building. The floor space fraction is the total floor space of low-income units in the building divided by the total floor space of residential rental units (whether or not occupied) in the building.

Subject to certain exceptions in section 42(i)(3)(B), section 42(i)(3) defines the term "low-income unit" as any unit in a building if the unit is rent-restricted and the

individuals occupying the unit meet the income limitation under section 42(g)(1) that applies to the project of which the building is a part.

Section 42(d)(1) and (2) describe how to calculate the eligible basis of a new building or an existing building, respectively.

Section 42(c)(2) defines the term "qualified low-income building" as any building which is part of a qualified low-income housing project at all times during the compliance period (as defined in section 42(i)(1), the period of 15 taxable years beginning with the first taxable year of the credit period).

For a project to qualify as a low-income housing project, it must satisfy one of the section 42(g) minimum set-aside tests, as elected by the taxpayer. Prior to the enactment of the Consolidated Appropriations Act of 2018, Public Law No. 115-141, 132 Stat. 348 (2018 Act), section 42(g) contained two minimum set-aside tests, known as the 20-50 test and the 40-60 test. Under the 20-50 test, an electing taxpayer cannot earn any low-income housing credits unless at least 20 percent of the residential units in the project both are rent-restricted and are occupied by tenants whose gross income is 50 percent or less of the area median gross income (AMGI). Under the 40-60 test, an electing taxpayer cannot earn any low-income housing credits unless at least 40 percent of the residential units in the project both are rent-restricted and are occupied by tenants whose gross income is 60 percent or less of AMGI.

The 2018 Act added section 42(g)(1)(C), which gives taxpayers a third option for their election of a minimum set-aside test—the average income test. Under the average income test, an electing taxpayer cannot earn any low-income housing credits unless—(i) 40 percent[1] or more of the residential units in the project both are rent-restricted and are occupied by tenants whose income does not exceed the imputed income limitation that the taxpayer designated with respect to the specific unit; and (ii) the average of the

[1] In the case of a project described in section 142(d)(6), this "40 percent" is replaced with "25 percent."

imputed income designations of these units does not exceed 60 percent of AMGI.

Special rules in section 42(g)(1)(C)(ii)(I) through (III) govern the income limitations of low-income units as well as the role of those limitations in the average income test. Under the 20-50 and 40-60 tests, the income limitations for all low-income units flow automatically from the taxpayer's election of one of those two set-side tests. In contrast, under the average income test, the electing taxpayer must designate each unit's imputed income limitation, which will then be taken into account in applying the test. In addition, section 42(g)(1)(C)(ii)(III) requires the imputed income limitation designated for any unit to be 20, 30, 40, 50, 60, 70, or 80 percent of AMGI.

Under section 42(g), once a taxpayer elects to use a particular set-aside test for a project, that election is irrevocable. Thus, once a taxpayer has elected to use any of the three tests, the taxpayer may not subsequently elect to use one of the others. Although a taxpayer may have elected the 20-40 or 40-60 test before the average income test became available, the later availability of the average income test does not affect the irrevocability of the earlier election.

Under section 42(m)(1), every State or local housing credit agency (Agency) making allocations of the ability to earn low-income housing credits must have a qualified allocation plan (QAP) to guide it in making those allocations.

Under section 42(m)(1)(B)(iii), a QAP must also contain a procedure that the Agency (or its agent) will follow in monitoring noncompliance with low-income housing credit requirements and in notifying the IRS of any such noncompliance. See §1.42-5 of the Income Tax Regulations for rules implementing this requirement.

Section 1.42-5(e)(2) provides that a QAP must require an Agency to provide prompt written notice to the owner of a low-income housing project if the Agency does not receive the certification described in §1.42-5(c)(1), or does not receive, or is not permitted to inspect, the tenant income certifications, supporting documentation, and

rent records described in §1.42-5(c)(2)(ii), or discovers by inspection, review, or in some other manner, that the project is not in compliance with the provisions of section 42.

Section 1.42-5(e)(4) both sets the correction period after an Agency has notified an owner under §1.42-5(e)(2) and provides that the correction period shall be that period specified in the monitoring procedure during which an owner must supply any missing certifications and bring the project into compliance with the provisions of section 42. The correction period is not to exceed 90 days from the date of the notice to the owner described in §1.42-5(e)(2). An Agency may extend the correction period for up to 6 months, but only if the Agency determines there is good cause for granting the extension.

On October 30, 2020, the Department of Treasury (Treasury Department) and the IRS published a notice of proposed rulemaking (REG-119890-18) in the ***Federal Register*** (85 FR 68816) proposing regulations setting forth guidance on the average income test under section 42(g)(1)(C) (2020 proposed regulations). On March 24, 2021, the Treasury Department and the IRS held a public hearing on the 2020 proposed regulations.

The possibility of a “cliff” (as described in following two paragraphs) was one of the main concerns that commenters expressed regarding the 2020 proposed regulations. Almost all projects earning low-income housing credits have more than the minimum number of low-income units needed for the project to qualify for the credits. Thus, with the 20-50 or 40-60 tests, a later discovery that some unit failed to be a low-income unit generally would reduce the amount of credit earned but would not totally preclude a project’s eligibility.

By contrast, in response to the 2020 proposed regulations, commenters were concerned about the following possibility with respect to the average income test: Suppose that a taxpayer identified well over 40 percent of units whose income limits

averaged exactly 60 percent of AMGI, and further suppose that one of the units with the lowest income limit turned out to fail the criteria for being a low-income unit. In that case, the remaining units identified by the taxpayer would have an average income above 60 percent. The commenters were concerned that, in this situation and except for time-limited mitigation measures described in the 2020 proposed regulations, the 2020 proposed regulations would apply the average income test to *all* remaining units. Discovery of a single unit's failure might occur only after the proposed mitigation measures were no longer available. Thus, because no mitigation would be possible, the entire project would fail the average income set-aside test and would be denied any low-income housing credits. Some commenters called this total disqualification a "cliff," and many believed that this result was inappropriate since, despite the loss of that unit, at least 40 percent of the units in the project were units whose income limits averaged to 60 percent or less of AMGI.

On October 12, 2022, the Treasury Department and the IRS published average-income-test final regulations (TD 9967) in the ***Federal Register*** (87 FR 61489) (2022 final regulations). In the same Treasury decision, the Treasury Department and the IRS published temporary regulations providing recordkeeping and reporting requirements needed to facilitate administrability of, and compliance with, the 2022 final regulations (temporary regulations).

Under the 2022 final regulations, a project for residential rental property meets the requirements of the average income test if the taxpayer's project contains a qualified group of units that constitutes 40 percent[2] or more of the residential units in the project. Section 1.42-19(b)(2)(i) requires the units in a qualified group to, first, individually satisfy the criteria that would qualify each unit as a low-income unit under section 42(i)(3) (the same criteria that apply to the 20-50 or 40-60 set-asides). Specifically, the rules in

[2] In the case of a project described in section 142(d)(6), this "40 percent" is replaced with "25 percent."

§1.42-19(b)(1)(i) through (iii) require that each unit be rent-restricted, occupants of the unit meet the income limitation for the unit, and no other provision in section 42 (including section 42(i)(3)(B) through (E)) or the regulations thereunder denies low-income status to the unit. In addition, §1.42-19(b)(2)(ii) requires that the average of the designated imputed income limitations of the units in the group not exceed 60 percent of AMGI. The qualified group of units must be identified as required in §1.42-19(b)(3)(i).

The Treasury Department and the IRS expected that commenters' concerns would be fully assuaged by the qualified group approach in the 2022 final regulations, as implemented with the flexibility in the temporary regulations.

In the same issue of the ***Federal Register*** in which the 2022 final and temporary regulations were published, the Treasury Department and the IRS published a notice of proposed rulemaking (REG–113068-22, 87 FR 61543) regarding the administration of the average income test (2022 proposed regulations). The text of the temporary regulations served as the text of the 2022 proposed regulations.

Four public comments were submitted in response to the 2022 proposed regulations. The comments are available for public inspection at *www.regulations.gov* or upon request.

The Treasury Department and the IRS considered all comments in the development of this Treasury decision, which follows the basic framework of the 2022 proposed and temporary regulations, with some revisions. The following Summary of Comments and Explanation of Revisions discusses the comments received and the revisions adopted.

In addition, the final regulations include some minor, non-substantive revisions to the 2022 proposed regulations that are not discussed in the Summary of Comments and Explanation of Revisions.

Summary of Comments and Explanation of Revisions

These final regulations provide recordkeeping and reporting requirements for the average income test under section 42(g)(1)(C).

I. Impact of Noncompliant Unit Included in Identified Qualified Group of Units

As with the 2020 proposed regulations, commenters expressed concern that the temporary regulations (and thus the 2022 proposed regulations) might be interpreted as again creating such a cliff effect in circumstances where a taxpayer identified well over 40 percent of units whose income limits averaged exactly 60 percent of AMGI. The commenters stated that the temporary regulations could be interpretated as meaning that a post-year-end discovery that one of the units with the lowest income limit failed the criteria for being a low-income unit could cause an entire project to lose eligibility to earn low-income housing credits. Specifically, if the later-discovered noncompliant unit was in the qualified group of units reported to the Agency to demonstrate compliance with the average income test, then excluding that unit's (below-60 percent of AMGI) income limit would cause the average of the remaining units in the identified group to exceed 60 percent of AMGI. Commenters also raised the possibility that the reported qualified group might contain exactly 40 percent of the units in the project, even though other units were available to include in the reported qualified group. In that case, removing the now-disqualified unit would reduce the qualified group of units to less than 40 percent of the project's total units.

In such cases, commenters suggested that the taxpayer could have taken steps to preserve the qualification of the project if the regulations allowed other units to be substituted in the qualified group that is used to satisfy the requirements of the average income test. Some of the comment letters proposed revising §1.42-19T(c)(4), regarding an Agency's waiver authority, to expressly allow a taxpayer to submit a corrected group of qualified units.

The 2022 final regulations were intended to eliminate the risk of a cliff.

Consistent with that intention, the temporary regulations were not intended to cause disqualification because of a post-year-end discovery that one of the identified units failed the criteria for being a low-income unit in circumstances where the taxpayer could have identified a different group of qualified units. The purpose of the recordkeeping and reporting rules for the average income test is similar to the rules for the other set-aside tests. Thus, the rules in the temporary regulations are intended to create a contemporaneous record of the qualified groups of units. This record helps document and later verify that the taxpayer met the requirements of the average income test and correctly calculated the applicable fraction of the building.

The Treasury Department and the IRS agree with commenters that the final regulations should more clearly allow the submission of a corrected qualified group when the taxpayer or Agency realizes that a previously submitted group fails to be a qualified group. For example, suppose that a unit with a 40 percent imputed income designation is included in a reported qualified group but is later determined to have been noncompliant during the relevant time period. In such a case, submitting a revised qualified group can document both the removal of that noncompliant unit and any removal of other units. For example, simultaneously removing the noncompliant unit and one or more higher-limitation units may be needed to reduce the average imputed income designations of units in the identified group down to 60 percent or less of AMGI. This updated reporting requirement will be helpful for demonstrating that the average income test was met as of the prior year end. It will also be useful for identifying more clearly the qualified group of units to be used for calculating the applicable fraction.

Accordingly, these final regulations adopt the commenters' suggestion to permit the submission of a corrected qualified group of units. The Treasury Department and the IRS note that allowing submission of a revised qualified group does not allow a taxpayer retroactively to change income designations for any unit in a building after a

taxable year has closed. A change in an income designation is not allowed even if a tenant's income would have supported a lower designation prior to year end.

II. Reporting of Two Groups of Qualified Units

Proposed § 1.42-19(c)(1)(ii) would require taxpayers to report two separate groups of qualified units: (i) one for the minimum set-aside test; and (ii) one for computing the applicable fractions of buildings in the project. Some commenters suggested that reporting two separate groups of qualified units is unnecessary because a single list of all units submitted for determining the applicable fraction would include the information needed to determine whether the minimum set-aside is met. Under the definition of qualified group, the designations of the low-income units in the applicable-fraction qualified group must average 60 percent or less of AMGI. Thus, if that group includes at least 40 percent of the units in the project, that group of units is a qualified group that satisfies the average-income set-aside.

The commenters recommended that the final regulations streamline the reporting process to allow a taxpayer to report to the Agency a single qualified group of low-income units that is large enough to include at least 40 percent of the residential units in the project. This qualified group of units demonstrates compliance with the set aside, and data on the units in each building represented in the group is available to compute the applicable fraction(s) for each such building.

Section 1.42-19(c) of the 2022 proposed regulations would give Agencies flexibility to determine the best time and manner for taxpayers to communicate the required information so that each Agency can adopt a system that best serves that particular Agency. This flexibility is intended to enable the Agency to minimize burden on the Agency and taxpayers.

The Treasury Department and the IRS agree with commenters that one list can be sufficient. However, it is important to maintain flexibility for any Agency that finds two

separate lists helpful. Thus, the final regulations revise the language in the 2022 proposed regulations to provide that Agencies have discretion to permit taxpayers to report either one or two qualified groups of low-income units. The final regulations also include examples illustrating the application of this rule.

III. Timing of Agency Waiver

Proposed § 1.42-19(c)(4) would provide Agencies with the discretion, on a case-by-case basis, to waive in writing any failure to comply with the proposed regulations' recordkeeping and reporting requirements. The waiver may be granted up to 180 days after discovery of the failure, whether by the taxpayer or Agency.

One commenter was concerned that 180 days may be insufficient to address a failure, especially if the waiver discretion is being used to remedy the “cliff test” reporting issue described earlier. This commenter recommended revising the final regulations so that the 180-day period starts with the determination of a designation or identification failure, rather than a discovery of a failure. The commenter suggested that this determination be defined as the Agency’s issuance to the IRS of Form 8823 (Low-Income Housing Credit Agencies Report of Noncompliance or Building Disposition). Other commenters recommended that the 180-day period start after the end of the correction period in §1.42-5(e)(4) (90 days after notice from Agency under §1.42-5(e)(2), plus up to an additional six months at Agency’s discretion).

The Treasury Department and the IRS considered these recommendations, and the final regulations adopt a revised version of the 2022 proposed regulations. These revisions align the §1.42-19 reporting requirements with the rules in §1.42-5. The modification in §1.42-19(c)(4) is also necessary because the final regulations now allow owners of low-income housing projects to submit a corrected list upon discovery of a problem with a previously submitted list, whether the discovery is by the taxpayer or Agency.

The final regulations in §1.42-19(c)(4) provide that a failure to comply with the procedural requirements of §1.42-19(c)(1), (c)(2), or (c)(3)(iv) is treated as corrected in three situations: (i) if a taxpayer discovers the failure to comply, the taxpayer has up to 180 days after discovery of the failure to give the Agency a revised submission, such as a revised qualified group of units; (ii) if an Agency discovers a failure to comply, the Agency should provide prompt notification in a manner similar to §1.42-5(e)(2), and then the taxpayer must satisfactorily address the failure within the correction period of §1.42-5(e)(4); or (iii) in all cases, an Agency has discretion to waive in writing any failure to comply with the procedural requirements of §1.42-19(c)(1), (c)(2), or (c)(3)(iv). This waiver must occur within the applicable time period (dependent on whether a taxpayer or Agency discovered failure). As indicated in the preceding paragraph, the final regulations distinguish noncompliance discovered by an Agency and noncompliance discovered by a taxpayer. In the case of a taxpayer discovery, providing the taxpayer with 180 days after discovery to give the Agency a revised submission should provide sufficient time for taxpayers to comply, because the period does not begin before taxpayers have knowledge, or an appreciation, that there is, indeed, a failure.

In contrast, when an Agency discovers the failure, the final regulations align with the rules that apply to an Agency discovery under §1.42-5. The Agency must provide prompt notice under §1.42-5(e)(2) to start the correction period in §1.42-5(e)(4). Aligning the §1.42-19 rules with the notice provision in §1.42-5(e)(2) and the correction period provided by §1.42-5(e)(4) places taxpayers and Agencies in the same position with an Agency-discovered average income issue as the taxpayer is in when the Agency discovered that otherwise failed to certify under §1.42-5, or when the Agency discovered any other noncompliance. The final regulations do not adopt commenters' suggestion to start the correction period after a "determination" by the Agency. Under that suggestion, determination means the issuance of a Form 8823 as detailed in §1.42-

5(e)(3). Adopting such a late deadline would misalign these rules with the rules in §1.42-5. For example, when an Agency "discovers" that a project is not in compliance with the provisions of section 42, §1.42-5(e)(2) requires the Agency to provide prompt written notice to start the correction period in §1.42-5(e)(4). If, instead, a "determination" were required for an Agency-discovered error regarding average-income, then the permitted correction period would extend past the date of the correction period for other Agency-discovered errors or failed certifications under §1.42-5(e)(4) (such as correcting the physical noncompliance of a unit). The burden on the taxpayer in this situation (submitting a corrected list of units) does not justify a longer or different period of time than other Agency-identified issues.

Effect on Other Documents

The temporary regulations are removed effective **[INSERT DATE OF PUBLICATION IN THE *FEDERAL REGISTER*]**.

Special Analyses

I. Regulatory Planning and Review – Economic Analysis

These final regulations are not subject to review under section 6(b) of Executive Order 12866 pursuant to the Memorandum of Agreement (July 4, 2025) between the Treasury Department and the Office of Management and Budget regarding review of tax regulations.

II. Paperwork Reduction Act

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

Section 1.42-19(c)(1) provides recordkeeping and reporting requirements related

to the identification of a qualified group of units for each of (i) satisfaction of the average income set-aside test and (ii) applicable fraction determinations. Section 1.42-19(c)(2) provides reporting requirements to the Agency with jurisdiction over a project. Section 1.42-19(c)(3)(iv) provides recordkeeping and reporting requirements related to designations of the imputed income limitations for residential units. Section 1.42-19(d)(2) provides recordkeeping and reporting requirements related to changing a unit's designated imputed income limitation.

This information in the collections of information will generally be used by the IRS and Agencies for tax compliance purposes and by taxpayers to facilitate proper reporting and compliance. Specifically, the collections of information in §1.42-19 apply to owners of projects that receive the low-income housing credit and elect the average income set-aside. With respect to the recordkeeping requirements in §1.42-19(c)(3)(iv), and (d)(2), section 42(g)(1)(C)(ii)(I) requires that the taxpayer designate the imputed income limitations of the units taken into account for purposes of the average income test. Thus, the recordkeeping requirements that are provided allow for a process of designation that will result in a reliable record of both the original designations of the imputed income limitations of low-income units and any redesignations of units' limitations within a project.

The recordkeeping rules in §1.42-19(c)(1) with respect to a qualified group of units are similarly needed to ensure there is a reliable record to show that the units used for purposes of the average income set-aside test and for determining a building's applicable fraction were part of a group of units within the project whose average designated imputed income limitations do not exceed 60 percent of AMGI. This limitation is consistent with the requirement in section 42(g)(1)(C)(ii)(II). The annual reporting requirements in §1.42-19(c)(1), (c)(3), and (d)(2) are also similar in substance to other annual certifications required of taxpayers. For example, minimum

certifications by owners are required in qualified allocation plans as provided in §1.42-5(c). The reporting requirements in these final regulations also provide added flexibility by allowing the applicable Agency to determine the time and manner for the reporting under §1.42-19(c)(2)(i). Also, §1.42-19(c)(4) gives taxpayers the ability to correct failures and maintains the Agencies the ability to waive any failure of reporting on a case-by-case basis.

A summary of paperwork burden estimates follows:

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

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

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

3,000 buildings).

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

Estimated frequency of response: Annual.

Estimated total burden hours: The annual burden hours for this regulation is estimated to be 13,350 hours. Using a monetization rate of $56.60 per hour (2024 dollars), the burden for this regulation is $755,610 for impacted taxpayers.

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

III. Regulatory Flexibility Act

Pursuant to the Regulatory Flexibility Act (RFA) (5 U.S.C. chapter 6), the Secretary of the Treasury hereby certifies that this final regulation will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that, prior to the publication of this final regulation and before the enactment of the 2018 Act, taxpayers were already required to satisfy either the 20-50 test or the 40-60 test, as elected by the taxpayer, in order to qualify as a low-income housing project. The 2018 Act added a third minimum set-aside test (the average income test) that taxpayers may elect. This final regulation sets forth requirements for the average income test, and the costs associated with the average income test are similar to the costs associated with the 20-50 test and 40-60 test.

As described in more detail in the PRA analysis section of the preamble, approximately 200 taxpayers elected the average income test for just over 2,000 buildings between 2018 and 2022. When viewed annually, we project that approximately 100 additional taxpayers will have eligible buildings and 1,000 additional

buildings will be eligible under the average income test. We estimate that identifying which units are for use in the average income set-aside test and applicable fraction determinations and designating a unit's imputed income limitation takes an average of 15 minutes per unit. Based on an estimated average of 15 units per building and an average 15 minutes of time per unit, an impacted taxpayer will incur an average of 225 minutes per building to record the additional designations due to the flexibility under the regulations for the average income test. In addition, taxpayers are also required to report redesignation of units, and why they are required to redesignate units during the year. For purposes of this analysis, we assume that an average of 4 units per building will be redesignated annually. We estimate each redesignation will take an average of 10 minutes. Thus, we estimate the average number of minutes per year to record redesignations for an impacted taxpayer to be 40 minutes per building for a total average annual burden of 2,000 hours. We also estimate an annual reporting burden related to the expanded flexibility rules to average 20 minutes per impacted taxpayer for a total burden of 100 hours.

IV. Section 7805(f)

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

V. Unfunded Mandates Reform Act

Section 202 of the Unfunded Mandates Reform Act of 1995 (UMRA) requires that agencies assess anticipated costs and benefits and take certain other actions before issuing a final rule that includes any Federal mandate that may result in expenditures in any one year by a State, local, or Tribal government, in the aggregate, or by the private sector, of $100 million in 1995 dollars, updated annually for inflation. This final rule does

not include any Federal mandate that may result in expenditures by State, local, or Tribal governments, or by the private sector in excess of that threshold.

VI. Executive Order 13132: Federalism

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

VII. Congressional Review Act

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

VIII. Executive Order 13175: Consultation and Coordination With Indian Tribal Governments

Executive Order 13175 (Consultation and Coordination With Indian Tribal Governments) prohibits an agency from publishing any rule that has Tribal implications if the rule either imposes substantial, direct compliance costs on Indian Tribal governments, and is not required by statute, or preempts Tribal law, unless the agency meets the consultation and funding requirements of section 5 of the Executive order. This final rule does not have substantial direct effects on one or more Federally recognized Indian tribes and does not impose substantial direct compliance costs on Indian Tribal governments within the meaning of the Executive order.

Drafting Information

The principal author of these regulations is Waheed Olayan, Office of the

Associate Chief Counsel (Energy, Credits, and Excise Tax). However, other personnel from the Treasury Department and the IRS participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1--INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by removing the entry for § 1.42–19T to read in part as follows:

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

* * * * *

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

* * * * *

Par. 2. Section 1.42-0 is amended by, in the table of contents for §1.42-19, adding entries for (c)(1), (c)(1)(i) and (ii), (c)(2), (c)(2)(i) and (ii), (c)(3)(iv), (c)(4), (c)(4)(i) through (iv), (d)(2), and (f)(4) to read as follows:

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§1.42-19 Average income test.

* * * * *
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(i) In general.
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(iv) Waiver by Agency.
(d) * * *
(2) Process for changing a unit's designated imputed income limitation.
* * * * *
(f) * * *
(4) Taxable years beginning on or after **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER].**

Par. 3. Section 1.42-19 is amended by:

1. Adding paragraphs (c)(1) and (2), (c)(3)(iv), (c)(4), and (d)(2).

2. Revising paragraphs (f)(1) and (f)(2)(ii).

3. Adding paragraph (f)(4).

The revisions and additions read as follows:

§1.42-19 Average income test.

* * * * *

(c) * * *

(1) *Identification of low-income units for use in the average income set-aside test or the applicable fraction determination*--(i) *In general*. For a taxable year, a taxpayer must follow the procedures described in paragraph (c)(1)(ii) of this section to identify--

(A) A qualified group of units that satisfy the average income set-aside test; and

(B) A qualified group of units to be used to determine the applicable fraction.

(ii) *Recording and communicating*. A taxpayer must--

(A) Record the identification in its books and records, where the identification must be retained for a period not shorter than the record-retention requirement under §1.42-5(b)(2); and

(B) Communicate the annual identifications to the applicable housing credit agency (Agency) as provided in paragraph (c)(2) of this section.

(2) *Notifications to the Agency with jurisdiction over a project*--(i) *Agency flexibility*. An Agency may establish the time and manner in which information is

annually provided to it.

(ii) *Examples*. The following fact patterns illustrate some of the approaches that paragraph (c)(2)(i) of this section allows an Agency to use to establish the time and manner in which a taxpayer annually provides information to the Agency.

(A) *Example 1*. Agency A requires taxpayers annually to submit a single list reporting all low-income units in a qualified group to be used by the taxpayer in determining the applicable fraction(s) for all building(s) in the project. The identification of each unit on the list must include the unit's imputed income designation. Consequently, Agency A can identify within the list a group or groups of units that constitute a qualified group that satisfies the average income set-aside test and taxpayers are considered to have identified a qualified group of units that satisfy the average income test.

(B) *Example 2*. Agency B has the same requirements for taxpayers as Agency A in paragraph (c)(2)(ii)(A) of this section (*Example 1*) for the initial annual report, but thereafter Agency B permits taxpayers, in lieu of a full list, to submit a statement describing the differences from the previous year's information (or, when applicable, by reporting that there are no such differences).

(C) *Example 3*. Agency C requires taxpayers to annually provide two separate lists of low-income units: one list identifying the qualified group of units for use in the average income set-aside; and a second list identifying the qualified group of units for use in the applicable fraction determination. The identification of each unit on the lists must include the unit's imputed income designation.

(3) * * *

(iv) *Recording, retention, and annual communications related to designations*. A taxpayer designates a unit's imputed income limitation by recording the limitation in its books and records, where it must be retained for a period not shorter than the record retention requirement under §1.42-5(b)(2). The preceding sentence applies both to units whose first occupancy is as a low-income unit and to previously market-rate units that are converted to low-income status. The designation must also be communicated annually to the applicable Agency as provided in paragraph (c)(2) of this section.

(4) *Correcting failures to comply with procedural requirements*--(i) *In general*. If there is a failure to comply with the requirements of paragraph (c)(1) or (2) or (c)(3)(iv) of this section and any of the procedures described in paragraph (c)(4)(ii), (iii), or (iv) of this section are followed, then the failure is treated as corrected and the relevant

requirements are treated as having been satisfied. In such case, the tax consequences under this section correspond to that deemed satisfaction.

(ii) *Discovery by taxpayer*. If a taxpayer discovers a failure to comply, the taxpayer must submit a correction to the Agency. Such a correction may be in the form of a revised qualified group of units. This submission must occur not more than 180 days after discovery of the failure.

(iii) *Discovery by Agency*. If an Agency discovers a failure to comply, the Agency must provide prompt notification to the taxpayer in a manner similar to the one described in §1.42-5(e)(2), and the taxpayer must submit a correction to the Agency within a time period no longer than the period described in §1.42-5(e)(4).

(iv) *Waiver by Agency*. In all cases, if a correction is required due to a failure to comply with the requirements of paragraph (c)(1) or (2) or (c)(3)(iv) of this section, then the Agency has the discretion to waive that failure in writing. For the waiver to be effective, this writing must be provided to the taxpayer within the time limit described in paragraph (c)(4)(ii) or (iii) of this section, as applicable.

(d) * * *

(2) *Process for changing a unit's designated imputed income limitation*. The taxpayer effects a change in a unit's imputed income limitation by recording the new designation in its books and records, where it must be retained for a period not shorter than the record retention requirement under §1.42-5(b)(2). The new designation must also be communicated to the applicable Agency as provided in paragraph (c)(2) of this section and must become part of the annual report to the Agency of income designations. The prior designation must be retained in the books and records for the period specified in paragraph (c)(3)(iv) of this section. A designation under this paragraph (d)(2) satisfies paragraph (c)(3) of this section.

* * * * *

(f) * * *

(1) *In general*. Except as provided in paragraphs (f)(3) and (4) of this section, this section applies to taxable years beginning after December 31, 2022.

(2) * * *

(ii) The designation required by paragraph (f)(2)(i) of this section must comply with paragraphs (c)(3)(ii) and (iv) of this section, without taking into account paragraph (c)(4) of this section. Paragraph (c)(2) of this section applies to these designations, except that the Agency may allow the notification to be made along with any other notifications for the first taxable year beginning after December 31, 2022.

* * * * *

(4) *Taxable years beginning on or after **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]***. Paragraphs (c)(1) and (2), (c)(3)(iv), (c)(4), (d)(2), and (f)(2)(ii) of this section apply to taxable years beginning on or after **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**. For taxable years beginning before **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**, see §1.42-19T as contained in 26 CFR part 1, as revised April 1, 2025. For taxable years beginning before **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**, taxpayers, however, may choose to apply the rules of paragraphs (c)(1) and (2), (c)(3)(iv), (c)(4), (d)(2), and (f)(2)(ii) of this section, provided the taxpayers apply the rules in their entirety and in a consistent manner.

§1.42-19T [Removed]

Par. 4. Section 1.42–19T is removed.

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Approved: September 19, 2025.

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