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March 2018

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Consolidated Appropriations Act 2018 Adds Third Optional Test for Qualified Low-Income Housing Projects and Increases Low-Income Housing Tax Credit Ceiling

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On December 22, 2017, President Donald Trump signed into law tax legislation commonly referred to as the Tax Cuts and Jobs Act (the "TCJA"). The TCJA was rushed through Congress, which resulted in several drafting errors, oversights, and disconnects that have been discovered during the months following the TCJA's effective date of January 1, 2018. On March 23, 2018, the President signed into law the Consolidated Appropriations Act, 2018 (the "CAA"), a $1.3 trillion spending bill which also includes a series of tax law corrections in order to address some of the errors in the TCJA.

One of the corrections in the CAA addressed the "grain glitch" in the TCJA that gave a competitive advantage to farmers who sell to cooperative grain suppliers under the Section 199A passthrough business income deduction. However, in order for Republicans to secure that change in the CAA, Democrats insisted on adding a provision that would add a third optional test for qualified low-income housing tax credit ("LIHTC") projects and boost the state housing credit ceiling for the LIHTC for calendar years 2018 through 2021.

Present Law

Section 42 of the U.S. Internal Revenue Code of 1986, as amended (the "Code"), provides for the LIHTC which may be claimed over a ten-year credit period after a low-income building is placed in service. Under Section 42(a) of the Code, the amount of the LIHTC for any taxable year in the credit period is the applicable percentage of the qualified basis of each qualified low-income building. The "applicable percentage" is 70% for new buildings which are not federally subsidized for the taxable year and 30% for all other buildings. The "qualified basis" of a qualified low-income building is determined by multiplying an applicable fraction (based on either units or floor space) by the eligible basis of such building which depends on whether the building is new or already in existence.

To be eligible for the LIHTC, a qualified low-income building must be part of a qualified low-income housing project. A qualified low-income housing project satisfies one of two tests at the election of the taxpayer: either (1) 20% or more of the residential units in the project are both rent-restricted and occupied by individuals whose income is 50% or less of the area median gross income (the "20-50 Test") or (2) 40% or more of the residential units in the project are both rent-restricted and occupied by individuals whose income is 60% or less of the area median gross income (the "40-60 Test").

If a unit is occupied by an individual whose income rises above 140% of the applicable income limit, the unit will continue to be treated as a low-income unit if the income of such individual initially met such income limitation and such unit continues to be rent-restricted. However, the next available unit must be occupied by a tenant whose income does not exceed such limitation. Special rules apply to deep rent skewed projects. A deep rent skewed project is a project in which (1) 15% or more of the low-income units in the project are occupied by individuals whose incomes are 40% or less of area median gross income, (2) the gross rent with respect to each low-income unit in the project does not exceed 30% of the applicable income limit that applies to individuals occupying the unit, and (3) the gross rent with respect to each low-income unit in the project does not exceed one-half of the average gross rent with respect to units of comparable size that are not occupied by individuals who meet the applicable income limit.

Under Section 42(h)(3) of the Code, a state housing credit ceiling applies. In order to determine the current-year state dollar amount of the ceiling in any calendar year, the greater of (1) $1.75 multiplied by the state population or (2) $2,000,000, is taken into account. These amounts, as indexed for inflation for calendar year 2018, are $2.40 and $2,760,000.

Addition of Average Income Test for Qualified Low-Income Housing Projects

The CAA adds a third optional test to the 20-50 Test and the 40-60 Test for a qualified low-income housing project. The average income test is met if 40% or more (25% or more, in the case of a project located in a high-cost housing area) of the residential units in such project are both rent-restricted and occupied by individuals whose income does not exceed the imputed income limitation designated by the taxpayer with respect to the respective unit.

The imputed income limitation is determined in ten-percentage-point increments from 20% to 80%, as designated by the taxpayer. The average of the imputed income limitations designated must not exceed 60% of the area median gross income.

If the taxpayer elects the average income test, and the income of the occupant of the unit increases above 140% of the greater of (1) 60% of the area median gross income or (2) the imputed income limitation designated by the taxpayer with respect to such unit, then such unit ceases to be treated as a low-income 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 the applicable imputed income limitation. In the case of a deep rent skewed project, 170% is used instead to measure the occupant's income.

This provision is effective for any elections made after March 23, 2018.

Increase in State LIHTC Ceiling

The CAA also provides an increase in the state LIHTC ceiling for calendar years 2018 through 2021. In each of those calendar years, the dollar amounts in effect for determining the current-year ceiling (after any increase due to the applicable cost of living adjustment under Section 42(h)(3)(H) of the Code) are increased by multiplying the dollar amounts for that year by 1.125. This provision is effective for calendar years beginning after December 31, 2017 and before January 1, 2022.

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