

Part III

Administrative, Procedural, and Miscellaneous

26 CFR 601.105: Examination of returns and claims for refund, credit or abatement; determination of correct tax liability.

(Also Part I, §§ 165; 1.165-7(a)(2), 1.165-7(b).)

Rev. Proc. 2010-36

SECTION 1. PURPOSE

This revenue procedure provides guidance to individuals regarding the federal income tax treatment of amounts paid to repair damage to their personal residences resulting from corrosive drywall building materials.

SECTION 2. BACKGROUND

.01 Reported problems have occurred with certain imported drywall installed in homes between 2001 and 2008. Homeowners have reported blackening or corrosion of copper electrical wiring and copper components of household appliances, as well as the presence of sulfur gas odors. In November 2009, the Consumer Product Safety Commission (CPSC) reported that an indoor air study of a sample of 51 homes found a

strong association between the problem drywall and levels of hydrogen sulfide in those homes and corrosion of metals in those homes. See the Commission's Drywall Information Center website, <http://www.cpsc.gov/info/drywall>. On January 28, 2010, the CPSC and the Department of Housing and Urban Development released interim guidance advising interested parties how to identify homes with problem drywall. See <http://www.cpsc.gov/info/drywall/InterimIDGuidance012810.pdf>.

.02 The Internal Revenue Service has received numerous inquiries from taxpayers about whether a loss resulting from corrosive drywall constitutes a deductible casualty loss within the meaning of § 165 of the Internal Revenue Code, the taxable year any such loss would be deductible, and how the amount of the loss would be computed.

.03 Section 165(a) of the Internal Revenue Code generally allows taxpayers to deduct losses sustained during the taxable year that are not compensated by insurance or otherwise. For personal-use property (such as a taxpayer's personal residence and household appliances), § 165(c)(3) limits an individual's deduction to losses arising from fire, storm, shipwreck, or other casualty, or from theft. A casualty is damage, destruction, or loss of property that results from an identifiable event that is sudden, unexpected, and unusual. Rev. Rul. 72-592, 1972-2 C.B. 101. Damage or loss resulting from progressive deterioration of property through a steadily operating cause is not a casualty loss. See Matheson v. Commissioner, 54 F.2d 537 (2d Cir. 1931).

.04 A casualty loss is allowed as a deduction only for the taxable year in which the loss is sustained. However, if the taxpayer has a claim for reimbursement of the

loss (from insurance or otherwise) for which there is a reasonable prospect of recovery, no portion of the loss is deductible until it can be ascertained with reasonable certainty whether or not such reimbursement will be received. See § 1.165–1(c)(4) of the Income Tax Regulations.

.05 The amount of a taxpayer's casualty loss generally is the decrease in the fair market value of the property as a result of the casualty, limited to the taxpayer's adjusted basis in the property. See § 1.165-7(b). To simplify the computation of a casualty loss deduction, existing regulations permit taxpayers to use the cost to repair the damaged property as evidence of the decrease in value of the property. See § 1.165-7(a)(2)(ii).

.06 Section 165(h)(1)-(2) imposes two limitations on casualty loss deductions for personal use property. First, a casualty loss deduction is allowable only for the amount of the loss that exceeds \$100 per casualty (\$500 for taxable years beginning in 2009 only). Second, the net amount of all of a taxpayer's casualty losses (in excess of casualty gains, if any) is allowable only for the amount of the losses that exceed 10 percent of the taxpayer's adjusted gross income (AGI) for the year.

.07 In view of the unique circumstances surrounding damage resulting from corrosive drywall, the Service and Treasury Department conclude that it is appropriate to provide a safe harbor method that treats certain damage resulting from corrosive drywall as a casualty loss and provides a formula for determining the amount of the loss. Accordingly, for an individual within the scope of this revenue procedure, the Service will not challenge the individual's treatment of damage resulting from corrosive

drywall as a casualty loss if the loss is determined and reported as provided in this revenue procedure.

SECTION 3. SCOPE

This revenue procedure applies to any individual who pays to repair damage to that individual's personal residence or household appliances that results from corrosive drywall.

SECTION 4. APPLICATION

.01 An individual who pays to repair damage to that individual's personal residence or household appliances that results from corrosive drywall may treat the amount paid as a casualty loss in the year of payment. For purposes of this revenue procedure, the term "corrosive drywall" means drywall that is identified as problem drywall under the two-step identification method published by the CPSC and the Department of Housing and Urban Development in their interim guidance dated January 28, 2010. As of the date of publication of this revenue procedure, the interim guidance can be found at <http://www.cpsc.gov/info/drywall/InterimIDGuidance012810.pdf>.

.02 The amount of a loss resulting from corrosive drywall may be limited depending on whether the taxpayer has a pending claim for reimbursement (or intends to pursue reimbursement) of the loss through property insurance, litigation, or otherwise. A taxpayer who does not have a pending claim for reimbursement (and does not intend to pursue reimbursement) may claim as a loss all unreimbursed amounts paid during the taxable year to repair damage to the taxpayer's personal residence and household appliances that results from corrosive drywall. A taxpayer who has a

pending claim for reimbursement (or intends to pursue reimbursement) may claim a loss for 75 percent of the unreimbursed amounts paid during the taxable year to repair damage to the taxpayer's personal residence and household appliances that resulted from corrosive drywall. A taxpayer who has been fully reimbursed before filing a return for the year the loss was sustained may not claim a loss. A taxpayer who has a pending claim for reimbursement (or intends to pursue reimbursement) may have income or an additional deduction in subsequent taxable years depending on the actual amount of reimbursement received. See § 1.165-1(d).

.03 Amounts paid for improvements or additions that increase the value of the taxpayer's personal residence above its pre-loss value are not allowed as a casualty loss. Only amounts paid to restore the taxpayer's personal residence to the condition existing immediately prior to the damage qualify for loss treatment.

.04 Where a household appliance is replaced rather than repaired, the amount of the loss attributable to the appliance is the lesser of the current cost to replace the original appliance or the basis of the original appliance (generally its cost).

.05 A taxpayer claiming a casualty loss under this revenue procedure must report the amount of the loss on Form 4684 ("Casualties and Thefts") and must mark "Revenue Procedure 2010-36" at the top of that form. Taxpayers are subject to the \$100 (\$500 for taxable years beginning in 2009 only) limitation imposed by § 165(h)(1) and the 10-percent-of-AGI limitation imposed by § 165(h)(2).

.06 Taxpayers who choose not to apply the safe harbor treatment provided by this revenue procedure are subject to all of the generally applicable provisions

governing the deductibility of losses under § 165. Accordingly, these taxpayers must establish that the damage, destruction, or loss of property resulted from an identifiable event that is sudden, unexpected, and unusual, and was not the result of progressive deterioration through a steadily operating cause. See Rev. Rul. 72-592, 1972-2 C.B. 101; Matheson v. Commissioner, 54 F.2d 537 (2d Cir. 1931). These taxpayers also must prove that the loss is properly deductible in the taxable year claimed by the taxpayer and not in some other year. Further, these taxpayers must prove the amount of the claimed loss and must prove that no claim for reimbursement of any portion of the loss exists for which there is a reasonable prospect of recovery.

SECTION 5. EFFECTIVE DATE

This revenue procedure is effective for federal income tax returns (including amended federal income tax returns) filed after September 29, 2010.

SECTION 6. DRAFTING INFORMATION

The principal author of this revenue procedure is Alan S. Williams of the Office of Associate Chief Counsel (Income Tax & Accounting). For further information regarding this revenue procedure contact Alan S. Williams at 202-622-4950 (not a toll free call).