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IRS Allows Deduction For Mold And Asbestos Removal

By Victor Sy, CPA, MBA

In welcome news to property rental owners, the IRS just issued a Private Letter Ruling allowing a taxpayer to deduct the cost to remove **mold** from a building that is owned and leased - as an **ordinary and necessary expense**.

As you know, repairs are **deductible** as ordinary and necessary expense under Code Sec. 162 if they merely keep the property in an **ordinary efficient operating condition**. On the other hand, expenses must be **capitalized if they add to the property's value, substantially prolong its useful life, or adopt it to a new or different use**.

The case involved a property owner who owned a building that was leased to a skilled nursing facility. Severe mold problems had developed in other parts of the building due to a series of roof leaks and condensation from heating, ventilation, and air conditioning lines. The owner undertook a mold remediation project to **remove the mold and restore the building to its physical condition before the onset of mold**. It removed and replaced 70% of wall and ceiling drywall. It also removed faucets, sinks, and electrical fixtures. The new materials were **similar in quality** to the replaced units. The existing floor plan was not altered and no structural components were repaired or replaced.

Note that mold removal is capitalized if made as part of an **overall rehabilitation** or renovation plan.

The IRS has previously ruled that the cost of **encapsulating** (covering or re-wrapping) exposed or damaged **asbestos**-containing pipe were **deductible** repair costs. The covering did not adopt the property to a new or different use. It was merely a temporary measure that would require more work if the materials become punctured or damaged in the normal course of operations.

The tax treatment of removing asbestos-containing materials from a building is different. The IRS and some courts have treated the cost of asbestos removal as capital improvement. The logic: removal reduces human health risks and therefore **increases the value of the property**.

If you have either mold or asbestos problems with your real estate rentals, ask your accountant to research Private Letter Ruling 200607003 for mold and 9411002 or 9240004 for asbestos.

Update: California just liberalized rules on **tax withholding on the sale of real estate**. For most sales of property other than a principal residence, California **withholds 3 1/3% of the sales price**. For Sales occurring after January 1, 2007, a new law allows the seller the option of having withholding taken at the rate of 9.3% of the estimated tax gain.