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from the Environmental Department

New TAM on Asbestos Removal

In a recently released Technical Advice Memorandum, 9411002, the IRS ruled that costs of asbestos removal must be capitalized, but that costs of asbestos encapsulation may be deducted currently. The ruling, which is highly focused on the specific factual circumstances, is described below.

The IRS has just released a new Technical Advice Memorandum ("TAM") on the tax treatment of costs incurred to abate asbestos contamination in buildings. The TAM addresses two factual circumstances involving a warehouse and an adjoining boiler house. The property, which was purchased in year 1, contained asbestos insulation at the time of purchase. The use of the boiler house to heat the warehouse was abandoned in year 2. In a subsequent [unspecified] year, the taxpayer was required by its lender to abate the asbestos in both facilities "in order to secure a bank loan for expansion of its facilities." The asbestos was removed from the boiler house, and the boiler house was converted to a two-truck garage and office space. The office space was rented to a related party. Portions of the asbestos insulation in the warehouse were encapsulated. The use of the warehouse in the taxpayer's business was unchanged.

Superficially, there is much about this TAM that appears favorable, but closer scrutiny is much less satisfying. Thus, while the result is one that probably will not provoke cries of outrage, the analysis and reasoning will, in the long run, be troublesome in different factual situations. Moreover, to the extent the IRS policy is seen as one which will allow current deductibility only when the source of contamination continues to pose a health hazard, such a policy is unnecessary and irresponsible.

The TAM holds that the removal costs must be capitalized and the encapsulation costs may be deducted currently.

Asbestos Removal

The TAM concludes that expenditures for removing asbestos from the boiler house must be capitalized for two separate reasons. First, the removal "increased the value, use and capacity of the taxpayer's property." Second, the expenditures "...adapt such property to a new and different use."

In support of the increase in value, use and capacity, the TAM recites the following factors as determinative:

1. The expenditures permanently eliminated the health risks posed by the presence of asbestos....Therefore, the expenditures created better operating conditions and prevented any further contamination of employees or lessees.

2. The expenditures made the property significantly more attractive to potential buyers, investors, lenders, and customers.

3. The expenditures enhanced the usefulness and capacity of the property by enabling the taxpayer to pro-