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, 1400M, 1400S; 1.165-7(a)(2), 1.165-7(b), 1.165-8(c))

Rev. Proc. 2006-32

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SECTION 1. PURPOSE

.01 This revenue procedure provides safe harbor methods that individual taxpayers may use in determining the amount of their casualty and theft loss deductions pursuant to § 165 of the Internal Revenue Code for their personal-use residential real property (as defined in section 3.02 of this revenue procedure) and personal belongings (as defined in section 3.03 of this revenue procedure) damaged, destroyed, or stolen as a result of Hurricanes Katrina, Rita, and Wilma (“the 2005 Gulf hurricanes”). Specifically, this revenue procedure provides three safe harbor methods that individuals may use to determine the decrease in fair market value of personal-use residential real property. This revenue procedure also provides a fourth safe harbor method that individuals may use to determine the fair market value of their personal belongings immediately before the 2005 Gulf hurricanes.

.02 The Internal Revenue Service will not challenge an individual’s determination of the decrease in fair market value of personal-use residential real property attributable to one of the 2005 Gulf hurricanes if the individual qualifies for and uses one of the safe harbor methods described in section 4 of this revenue procedure. Furthermore, the IRS will not challenge an individual’s determination of the fair market value of personal belongings immediately before one of the 2005 Gulf hurricanes if the individual qualifies for and uses the safe harbor method described in section 7 of this revenue procedure.

.03 Finally, this revenue procedure requires that if an individual uses the Cost Indexes Safe Harbor Method described in section 4.04 of this revenue procedure, the individual also must take into account the value of any no-cost repairs as described in section 6 of this revenue procedure.

.04 Use of a safe harbor method described in this revenue procedure is not mandatory. An individual may, instead, use the actual reduction in the fair market value of personal-use residential real property or personal belongings, pursuant to § 1.165-7(a)(2) of the Income Tax Regulations, if the individual has proper substantiation.

.05 The safe harbor methods provided in this revenue procedure apply only to the circumstances within the scope of this revenue procedure and may not be used in any other circumstances.

SECTION 2. BACKGROUND

.01 Section 165(a) generally provides that a taxpayer may deduct any loss sustained during the taxable year and not compensated for by insurance or otherwise. With respect to property not connected with a trade or business or a transaction entered into for profit, § 165(c)(3) limits an individual taxpayer's deductions to losses arising from fire, storm, shipwreck, or other casualty, or from theft.

.02 Section 165(h) imposes two limitations on casualty and theft loss deductions for property not connected with a trade or business or transaction entered into for profit. Section 165(h)(1) provides that any loss to an individual described in § 165(c)(3) shall be allowed only to the extent that the amount of the loss arising from each casualty, or from each theft, exceeds $100. Section 165(h)(2) provides that if personal casualty and theft losses for any taxable year exceed personal casualty and theft gains for the taxable year, the losses are allowed only to the extent of the sum of the amount of the gains, plus so much of the excess as exceeds ten percent of the adjusted gross income of the individual.

.03 Section 1400M(2) defines "Hurricane Katrina disaster area" as an area with respect to which a major disaster has been declared by the President before September 14, 2005, under § 401 of Robert T. Stafford Disaster Relief and Emergency Assistance Act ("Stafford Act") (42 USC § 5170) by reason of

Hurricane Katrina. The Hurricane Katrina disaster area covers the entire states of Alabama, Florida, Louisiana, and Mississippi. Section 1400M(4) defines "Hurricane Rita disaster area" as an area with respect to which a major disaster has been declared by the President before October 6, 2005, under § 401 of the Stafford Act by reason of Hurricane Rita. The Hurricane Rita disaster area covers the entire states of Louisiana and Texas. Section 1400M(6) defines "Hurricane Wilma disaster area" as an area with respect to which a major disaster has been declared by the President before November 14, 2005, under § 401 of the Stafford Act by reason of Hurricane Wilma. The Hurricane Wilma disaster area covers the entire state of Florida.

.04 Section 1400S(b) suspends the limitations on personal casualty and theft loss deductions imposed by § 165(h) if the losses are attributable to the applicable 2005 Gulf hurricane and arose in the (1) Hurricane Katrina disaster area on or after August 25, 2005, (2)Hurricane Rita disaster area on or after September 23, 2005, or (3) Hurricane Wilma disaster area on or after October 23, 2005.

.05 Section 1.165-1(c)(4) provides that in determining the amount of loss sustained, adjustments must be made for any insurance or other compensation received.

.06 Section 1.165-7(b) provides that the amount of a casualty loss is the lesser of (1) the difference between the fair market value of the property immediately before the casualty and the fair market value immediately after the casualty, or (2) the adjusted basis of the property. Section 1012 and § 1.1012-

1(a) provide that the basis of property generally is its cost. Section 1016(a)(1) and § 1.1016-2(a) provide that the basis of property is adjusted for any expenditure, receipt, loss, or other item, properly chargeable to capital account, including the cost of improvements and betterments made to the property.

.07 Section 1.165-7(a)(2)(i) provides that to determine the amount of the deductible loss under section 165(a), the fair market value of the property immediately before and immediately after the casualty generally shall be ascertained by competent appraisal. Section 1.165-7(a)(2)(ii) provides that the cost of repairs to the property damaged is acceptable as evidence of the decrease in value of the property if the taxpayer shows that: (1) the repairs are necessary to restore the property to its condition immediately before the casualty; (2) the amount spent for such repairs is not excessive; (3) the repairs do not care for more than the damage suffered; and (4) the value of the property after the repairs does not, as a result of the repairs, exceed the value of the property immediately before the casualty. In order to use the cost-of-repairs method to determine the decrease in fair market value, the taxpayer must actually make the repairs rather than rely on estimates of repairs that will be performed in the future or not at all. See Lamphere v. Commissioner, 70 T.C. 391, 396 (1978), acq., 1978-2 C.B. 2; Farber v. Commissioner, 57 T.C. 714, 719 (1972), acq., 1972-2 C.B. 2.

.08 Section 1.165-8(c) provides that the amount deductible in the case of a theft loss is determined consistently with the manner described in § 1.165-7 for determining the amount of a casualty loss. The fair market value of the property immediately after the theft is considered to be zero.

.09 Section 1.165-7(b)(2)(ii) provides that in determining a casualty loss involving real property and improvements thereon not used in a trade or business or in any transaction entered into for profit, the improvements (such as buildings and ornamental trees and shrubbery) to the property damaged or destroyed are considered an integral part of the property, and no separate basis need be apportioned to the improvements.

.10 Due to the widespread devastation from the 2005 Gulf hurricanes, it may be difficult for individuals to determine the decrease in the fair market value of damaged, destroyed, or stolen property using the methods provided in § 1.165-7(a)(2). The IRS and Treasury Department recognize that the statutory suspension of § 165(h) limitations on 2005 Gulf hurricane casualty loss deductions provided by § 1400S reflects Congressional intent to facilitate certain deductions. In view of these unique circumstances, the IRS and Treasury Department believe it is appropriate to provide safe harbor methods for use in determining the amount of casualty and theft loss deductions for certain property damaged, destroyed, or stolen as a result of the 2005 Gulf hurricanes. Therefore, this revenue procedure provides safe harbor methods that individuals may use under § 1.165-7(a)(2)(i) to measure the decrease in the fair market value of their personal-use residential real property that was damaged or destroyed and to determine the pre-hurricane fair market value of personal belongings that were damaged, destroyed, or stolen as a result of one of the 2005 Gulf hurricanes.

SECTION 3. SCOPE

.01 In general. An individual who suffered a casualty or theft loss for the individual's personal-use residential real property or personal belongings damaged, destroyed, or stolen as result of the 2005 Gulf hurricanes may use the safe harbor methods provided in this revenue procedure in determining the amount of the individual's casualty and theft loss deductions under § 165.

.02 Definition of personal-use residential real property and personal residence. For purposes of this revenue procedure, personal-use residential real property is real property, including improvements (such as buildings and ornamental trees and shrubbery, that is owned by the individual who suffered a casualty loss, that contains at least one personal residence, and that is not used in a trade or business or in a transaction entered into for profit. Personal-use residential real property does not include rental property. For purposes of this revenue procedure, a personal residence is a single family residence, or a single unit within a contiguous group of attached residential units (for example, a townhouse or duplex), owned by the individual who suffered a casualty loss, and consists of the total enclosed square footage of the residence or single unit, including any enclosed structures attached to the residence or single unit. For example, a personal residence includes a basement and an attached garage, but does not include a deck or screened-in porch. For purposes of this revenue procedure, a personal residence does not include a condominium or cooperative unit, or any other property for which the individual who suffered the casualty loss does not own the structural components of the building (such as the foundation, walls, and roof), or owns only a fractional interest in all of the structural components of the building, or a mobile home or trailer.

.03 Definition of personal belongings. For purposes of this revenue procedure, a personal belonging is an item of tangible personal property that is owned by the individual who suffered a casualty or theft loss and that is not used in a trade or business or in a transaction entered into for profit. For purposes of this revenue procedure, personal belongings do not include a boat, aircraft, mobile home, trailer, or vehicle (as defined in section 7.02 of this revenue procedure), or an antique or other asset that maintains or increases its value over time.

.04 Use of three personal-use residential real property safe harbor methods. An individual described in section 3.01 of this revenue procedure may use any of the three safe harbor methods described in section 4 of this revenue procedure to determine the decrease in fair market value for personal-use residential real property located in the Hurricane Katrina disaster area, Hurricane Rita disaster area, or Hurricane Wilma disaster area (see section 2.03 of this revenue procedure) that was damaged or destroyed as a result of one or more of the 2005 Gulf hurricanes. The three personal-use residential real property safe harbor methods are the Insurance Safe Harbor Method described in section 4.02 of this revenue procedure, the Contractor Safe Harbor Method described in section 4.03 of this revenue procedure, and the Cost Indexes Safe Harbor Method described in section 4.04 of this revenue procedure.

.05 Use of Cost Indexes Safe Harbor Method. An individual may use the Cost Indexes Safe Harbor Method if the individual's personal-use residential real property has suffered, in the circumstances described below, (1) a total loss of a personal residence, (2) a near total loss of a personal residence, (3) interior flooding over 1 foot of a personal residence, (4) structural damage from wind, rain, or debris to a personal residence, (5) roof covering damage from wind, rain, or debris to a personal residence, (6) damage to a detached structure, or (7) damage to wood decking:

(1) Total loss. A total loss of a personal residence occurs if, as a result of a storm surge or catastrophic prolonged flooding due to breaching or overtopping of a protective levee system during one of the 2005 Gulf hurricanes, any one of the following occurred:

(a) The personal residence either collapsed or is structurally unsound (for example, the structural connections in the personal residence, such as nails and anchor bolts, have corroded as a result of prolonged exposure to salt water (including brackish water) over an extended period of time to the extent that they compromise the structural integrity of the personal residence);

(b) The state or local government or any political subdivision thereof has ordered that the personal residence be demolished or relocated;

(c) The individual has sold the personal residence to an unrelated party for a price that reflects the fair market value solely of the land on which the personal residence is situated; or

(d) The personal residence sustained damage that satisfies the definition of near total loss, as described in section 3.05(2) of this revenue procedure, and the individual has demolished the personal residence.

(2) Near total loss. The near total loss of a personal residence occurs if, as a result of a storm surge or catastrophic prolonged flooding due to breaching or overtopping of a protective levee system during one or more of the 2005 Gulf hurricanes, the personal residence sustained severe damage necessitating the removal and disposal of substantially all interior wall frame coverings (including drywall and other wall frame coverings), floorings, electrical lines, ducts, plumbing, and other fixtures. For a personal residence sustaining near total loss, only the wood frame, rafters, and outside façade of the personal residence remain structurally sound and reusable.

(3) Interior flooding over 1 foot. Interior flooding over 1 foot occurs if a personal residence was flooded with salt water (including brackish water) to a height of more than 1 foot as a result of a storm surge or catastrophic prolonged flooding due to breaching or overtopping of a protective levee system during one or more of the 2005 Gulf hurricanes, but did not sustain damage that falls within the definition of total loss or near total loss, as described in section 3.05(1) and (2) of this revenue procedure.

(4) Structural damage from wind, rain, or debris. Structural damage from wind, rain, or debris occurs if a personal residence sustained major structural damage to the roof and/or outside wall(s) as a result of wind or windblown debris from one or more of the 2005 Gulf hurricanes that exposed part or all of the interior of the personal residence to rain or debris, requiring substantial renovation of the damaged areas. Substantial renovation requires the removal and replacement of drywall or other wall frame coverings, replacement of trim, and repair and painting of the damaged interior areas of the personal residence.

(5) Roof covering damage from wind, rain, or debris. Roof covering damage from wind, rain, or debris occurs if a personal residence sustains damage from wind, rain, or windblown debris to roofing felt, shingles, flashings, fascia, or soffit as a result of one or more of the 2005 Gulf hurricanes.

(6) Detached structures. A detached structure consists of a detached structure on personal-use residential real property where the detached structure sustained damage from one or more of the 2005 Gulf hurricanes to the extent that it requires either complete or major rebuilding. A detached structure includes a shed, shop, or detached garage that is not used in connection with a trade or business and that is not equipped with heating or air conditioning. Furthermore, a detached structure is of enclosed wood-frame construction, with some electrical capabilities and little or no interior finishing.

(7) Wood decking. Wood decking consists of pressure treated wood decking attached to a personal residence where the decking was damaged or destroyed by one of the 2005 Gulf hurricanes.

.06 Taking into account no-cost repairs. An individual using the Cost Indexes Safe Harbor Method described in section 4.04 of this revenue procedure must take into account the value of any no-cost repairs as described in section 6 of this revenue procedure.

.07 Use of Personal Belongings Safe Harbor Method. An individual may use the Personal Belongings Safe Harbor Method described in section 7.01 of this revenue procedure to determine the pre-hurricane fair market value of the individual's personal belongings located in the Hurricane Katrina disaster area, Hurricane Rita disaster area, or Hurricane Wilma disaster area (see section 2.03 of this revenue procedure) that were damaged, destroyed, or stolen as a result of one of the 2005 Gulf hurricanes.

.08 Limited use of safe harbor methods. The safe harbor methods described in sections 4 and 7 are available only in the circumstances described in this revenue procedure.

SECTION 4. PERSONAL-USE RESIDENTIAL REAL PROPERTY SAFE HARBOR METHODS

.01 In general. An individual within the scope of this revenue procedure may use any one of the three safe harbor methods described in this section 4. If an individual owns two or more parcels of personal-use residential real property, the use of a safe harbor method for one parcel does not require the individual to use the same safe harbor method, or any safe harbor method, for any other parcel.

.02 Insurance Safe Harbor Method. Under the Insurance Safe Harbor Method, to determine the decrease in the fair market value of the individual's personal-use residential real property, an individual may use the estimated loss determined in reports prepared by the individual's homeowners' or flood insurance company setting forth the estimated loss the individual sustained as a result of the damage to or destruction of the individual's personal-use residential real property from one of the 2005 Gulf hurricanes.

.03 Contractor Safe Harbor Method. Under the Contractor Safe Harbor Method, to determine the decrease in the fair market value of the individual's personal-use residential real property, an individual may use the contract price for the repairs specified in an itemized contract prepared by a contractor, licensed or registered in accordance with State or local regulations, setting forth the costs to restore the individual's personal-use residential real property to the condition existing immediately prior to the applicable 2005 Gulf hurricane. However, the costs of any improvements or additions that increase the value of the personal-use residential real property above its pre-hurricane value, such as the cost to elevate the personal residence to meet new construction requirements, must be excluded from the contract price for purposes of this safe harbor. To use the Contractor Safe Harbor Method, the contract must be a binding contract signed by the individual and the contractor.

.04 Cost Indexes Safe Harbor Method.

(1) In General. Under the Cost Indexes Safe Harbor Method, an individual may use one or more of the cost indexes, as applicable, provided in this section 4.04 to determine the decrease in the fair market value of personal-use residential real property, including the personal residence, detached structures, and wood decking. Cost indexes are provided for three size categories of personal residences based on the square footage of the personal residence.

In computing the decrease in fair market value under the Cost Indexes Safe Harbor Method, an individual must take into account the value of any no-cost repairs as described in section 6 of this revenue procedure.

If the Cost Indexes Safe Harbor Method described in this section 4.04 is used, the amount determined is the full amount of the decrease in fair market value of that personal-use residential real property, and may not be increased by amounts related to items such as landscaping, debris removal, demolition, etc.

The Cost Indexes Safe Harbor Method applies only to the following three types of improvements on an individual's personal-use residential real property: a personal residence (as described in section 3.02 of this revenue procedure), a detached structure (as described in section 3.05(6) of this revenue procedure), and a pressure treated wood deck (as described in section 3.05(7) of this revenue procedure). If there is any other type of improvement on an individual's personal-use residential real property that is not described in sections 3.02, 3.05(6) and 3.05(7) of this revenue procedure, the individual may use the Cost

Indexes Safe Harbor Method to determine the decrease in fair market value of the personal-use residential real property, but may not add any amount for the other type of improvements. For example, under the Cost Indexes Safe Harbor Method, no amount may be added to the decrease in fair market value of the personal-use residential real property for a residence that contains a home office, a residence in a structure that contains five or more residential units, a detached structure equipped with heating or air conditioning, or a deck made of synthetic material or hardwood that is not pressure treated.

(2) Special rules for Cost Indexes Safe Harbor Method.

(a) A personal residence may not be subject to more than one of the following tables: Table 1 (Total Loss); Table 2 (Near Total Loss); or Table 3 (Interior Flooding Over 1 Foot).

(b) A personal residence subject to Table 3 (Interior Flooding Over 1 Foot) also may be subject to Table 4 (Structural Damage From Wind, Rain, or Debris), but the square footage flooded may not be included in the square footage used for Table 4 (Structural Damage From Wind, Rain, or Debris).

(c) A personal residence subject to Table 3 (Interior Flooding Over 1 Foot) or Table 4 (Structural Damage From Wind, Rain, or Debris) may also be subject to Table 5 (Roof Covering Damage from Wind, Rain, or Debris).

(d) Table 6 (Detached Structures) and Table 7 (Wood Decking) may apply to any personal-use residential real property to which Table 1 (Total Loss), Table 2 (Near Total Loss), or Table 3 (Interior Flooding Over 1 Foot),

Table 4 (Structural Damage From Wind, Rain, or Debris), or Table 5 (Roof Covering Damage From Wind, Rain, or Debris) apply.

(e) If an individual's personal-use residential real property contains more than one personal residence and the individual uses the Cost Indexes Safe Harbor Method, the individual must apply the applicable table, or combination of tables, to each personal residence.

(3) Tables. The following tables set forth the cost indexes for each corresponding category described in section 3.05 of this revenue procedure:

Table 1 – Total Loss

Cost Indexes - Total Loss	
Personal Residence Size	Cost Index per sq. ft.
Small Personal Residence (Personal residence is less than 1,500 square feet)	$175
Medium Personal Residence (Personal residence is between 1,500 and 3,000 square feet)	$148
Large Personal Residence (Personal residence is greater than 3,000 square feet)	$132

For a personal residence that falls within the description of a total loss in section 3.05(1) of this revenue procedure, use Table 1 as follows:

(1) Determine the total square footage of the personal residence.

(2) Determine the size of the personal residence based on the total square footage described in Table 1.

(3) Multiply the total square footage of the personal residence (from step 1) by the applicable Cost Index in column 2 of Table 1.

Table 2 – Near Total Loss

Cost Indexes – Near Total Loss	
Personal Residence Size	Cost Index per sq. ft.
Small Personal Residence (Personal residence is less than 1,500 square feet)	$142
Medium Personal Residence (Personal residence is between 1,500 and 3,000 square feet)	$120
Large Personal Residence (Personal residence is greater than 3,000 square feet)	$107

For a personal residence that falls within the description of a near total loss in section 3.05(2) of this revenue procedure, use Table 2 as follows:

(1) Determine the total square footage of the personal residence.

(2) Determine the size of the personal residence based on the total square footage described in Table 2.

(3) Multiply the total square footage of the personal residence (from step 1) by the applicable cost index in column 2 of Table 2.

Table 3 – Interior Flooding Over 1 Foot

Cost Indexes – Interior Flooding Over 1 Foot	
Personal Residence Size	Cost Index per sq. ft.
Small Personal Residence (Personal residence is less than 1,500 square feet)	$108
Medium Personal Residence (Personal residence is between 1,500 and 3,000 square feet)	$ 92
Large Personal Residence (Personal residence is greater than 3,000 square feet)	$ 82

The cost indexes in Table 3 are applied only to the square footage of the personal residence that was flooded, rather than the total square footage.

For a personal residence that was flooded by salt water (including brackish water) to a height of greater than 1 foot, as described in section 3.05(3) of this revenue procedure, and does not fall within the description of a total loss or near total loss in sections 3.05(1) and (2) of this revenue procedure, use Table 3 as follows:

(1) Determine the total square footage of the personal residence.

(2) Determine the size of the personal residence based on the total square footage described in Table 3.

(3) Determine the square footage of the flooded area of the personal residence.

(4) Multiply the flooded square footage (from step 3) by the applicable cost index in column 2 of Table 3.

Table 4 – Structural Damage From Wind, Rain, or Debris

Cost Indexes – Structural Damage From Wind, Rain, or Debris	
Percent of Damage Category Percent Damaged = Square Footage of Damaged Area / Total Square Footage of Personal Residence	
Percent Damaged	Cost Index per sq. ft.
15% to 25%	$143
26% to 50%	$132
51% to 100%	$119

The cost indexes in Table 4 apply only to the square footage of the damaged area of the personal residence, rather than the total square footage.

Personal residences that sustained 100% wind, rain, or debris damage are those that sustained major structural damage throughout the entire personal residence necessitating substantial renovation (as defined in section 3.05(4) of this revenue procedure) of all of the rooms in the personal residence.

For a personal residence that sustained structural damage from wind, rain, or debris, use Table 4 as follows:

(1) Determine the total square footage of the personal residence.

(2) Determine the square footage of the damaged portion of the personal residence by adding the square footage of each room needing substantial renovation.

(3) Determine the percent of square footage of the personal residence that was damaged by dividing the square footage that was damaged (from step 2) by the total square footage (from step 1).

(4) Multiply the square footage of the damaged area (from step 2) by the applicable cost index in column 2 of Table 4 (based on the percent of damage range in column 1 of Table 4).

Table 5 – Roof Covering Damage From Wind, Rain, or Debris

Cost Indexes – Roof Covering Damage From Wind, Rain, or Debris	
Personal Residence Size	Cost Index per sq. ft.
Small Personal Residence (Personal residence is less than 1,500 square feet)	$6.00
Medium Personal Residence (Personal residence is between 1,500 and 3,000 square feet)	$5.75
Large Personal Residence (Personal residence is greater than 3,000 square feet)	$5.50

If the personal residence sustained roof covering damage from wind, rain, or debris as described in section 3.05(5) of this revenue procedure, apply the applicable cost index in Table 5 to the total square footage under the roof (including the porch, patios, and overhangs).

For a personal residence that sustained roof covering damage from wind, rain, or debris, as described in section 3.05(5) of this revenue procedure, use Table 5 as follows:

(1) Determine the total square footage of the ground floor of the personal residence.

(2) Add to the total square footage of the ground floor (from step 1) the square footage of any area of the roof that extends beyond the ground floor, such as porches and attached carports, to determine the total square footage under the roof.

(3) Determine the applicable cost index in column 2 of Table 5 based on the total square footage of the personal residence.

(4) Multiply the total square footage under the roof (from step 2) by the applicable cost index in column 2 of Table 5 (from step 3).

Table 6 – Detached Structures

Cost Indexes – Detached Structures	
Detached Structure Size	Cost Index per sq. ft.
Up to 200 square feet	$48
Over 200 and up to 400 square feet	$38
Over 400 square feet	$33

For a detached structure on personal-use residential real property, as described in section 3.05(6) of this revenue procedure, apply the applicable cost index in Table 6 as follows:

(1) Determine the total square footage of the detached structure.

(2) Determine the size of the detached structure based on the total square footage described in column 1 of Table 6.

(3) Multiply the total square footage of the detached structure (from step 1) by the applicable cost index in column 2 of Table 6.

Table 7 – Wood Decking

Cost Index – Wood Decking	
	Cost Index per sq. ft.
Use for all sizes of wood decking	$15

For pressure treated wood decking attached to a personal residence, as described in section 3.05(7) of this revenue procedure, apply the cost index in Table 7 as follows:

(1) Determine the square footage of the damaged area of the deck.

(2) Multiply the square footage of the damaged area of the deck (from step 1) by the cost index in column 2 of Table 7.

SECTION 5. COST INDEXES SAFE HARBOR METHOD EXAMPLES

The following examples illustrate the application of the Cost Indexes Safe Harbor Method described in section 4.04 of this revenue procedure.

Example 1. Prior to Hurricane Katrina, an individual purchased a personal residence for $300,000. The personal residence is 2,000 square feet and the personal-use residential real property does not contain any decking or detached structures. The personal residence was flooded by nine feet of salt water for over three weeks due to a breach in a levee, causing the structural connections in the personal residence to corrode to the extent they must be replaced. The personal residence is located in the Hurricane Katrina disaster area. Insurance and other reimbursements total $100,000. The individual obtained from the insurance company a report setting forth the estimated damage to the personal residence. The individual also obtained from a licensed contractor a binding contract signed by the contractor and the individual itemizing the contract price to repair the damage to the personal residence. The individual chooses to use the Cost Indexes Safe Harbor Method. Because the salt water corrosion damage to the personal residence falls within the definition of total loss, as defined in section 3.05(1) of this revenue procedure, the individual uses Table 1 of the Cost Indexes Safe Harbor Method to determine the decrease in fair market value of the personal-use residential real property. The individual multiplies the square footage of the personal residence by the cost index for a Medium Personal Residence in Table 1, as follows:

2,000 sq. ft. x $148/sq. ft. = $ 296,000

The individual compares the decrease in fair market value, $296,000, with the basis in the personal-use residential real property, $300,000, and from the smaller of these two amounts, $296,000, subtracts the insurance and other reimbursements of $100,000. The individual is entitled to a casualty loss deduction of $196,000 ($296,000 - $100,000).

Example 2. Assume the same facts in Example 1, except that the individual purchased the personal-use residential real property twenty years ago for $120,000, and paid no additional amounts for improvements or remodeling. The individual compares the decrease in fair market value, calculated using the Cost Indexes Safe Harbor Method in Example 1, with the basis of the personal-use residential real property. Since the basis of $120,000 is less than the decrease in fair market value, $296,000, the individual's casualty loss is limited to the basis of $120,000. After subtracting insurance and other reimbursements of $100,000 from the basis of $120,000, the individual is entitled to a casualty loss deduction of $20,000 ($120,000 - $100,000 = $20,000).

Example 3. The individual's personal residence is substantially damaged by a storm surge from Hurricane Katrina. The individual's personal-use residential real property is located in the Hurricane Katrina disaster area. The damage falls within the definition of near total loss, as defined in section 3.05(2) of this revenue procedure, since all of the drywall, floorings, electrical lines, ducts, plumbing, and other fixtures need to be replaced. Prior to Hurricane Katrina, the individual purchased the personal-use residential real property for $190,000 and spent $10,000 for improvements to remodel the residence. Immediately prior to Hurricane Katrina, the adjusted basis of the property was $200,000 ($190,000 cost + $10,000 improvements). The personal residence is 2,000 square feet and the personal-use residential real property does not contain any decking or detached structures. The individual paid $5,000 to have debris cleared from the personal-use residential real property. Insurance and other reimbursements total $100,000.

Because the damage to the personal residence falls within the definition of near total loss, the individual uses Table 2 of the Cost Indexes Safe Harbor Method to determine the decrease in fair market value of the personal-use residential real property. Using Table 2 of the Cost Indexes Safe Harbor Method, the decrease in fair market value of the personal-use residential real property is determined by multiplying the square footage of the personal residence by the cost index for a Medium Personal Residence as follows:

2,000 sq. ft. x $120/sq. ft. = $240,000

Because the individual chooses to use the Cost Index Safe Harbor Method for determining the decrease in fair market value, the $5,000 debris removal costs are not added to the safe harbor amount of $240,000. The individual compares the adjusted basis of the personal-use residential real property to the decrease in fair market value determined by using the Cost Indexes Safe Harbor Method. Since the adjusted basis of $200,000 is less than the decrease in fair market value, $240,000, the individual's casualty loss is limited to the adjusted basis of $200,000. After subtracting $100,000, the amount of insurance and other reimbursements received, from the adjusted basis of $200,000, the individual is entitled to a casualty loss deduction of $100,000 ($200,000 - $100,000 = $100,000).

Example 4. The first floor of an individual's personal residence was flooded with 4 feet of salt water as a result of a storm surge during Hurricane Katrina. As a result of the flooding, all of the flooring and drywall on the first floor needs to be replaced. The second floor of the personal residence is not damaged. While the personal residence sustained flooding of more than 1 foot of salt water, it did not sustain damage that falls within the definition of total loss or near total loss in sections 3.05(1) and (2) of this revenue procedure. Therefore, the personal residence sustained interior flooding over 1 foot as described in section 3.05(3) of this revenue procedure. In addition, the pressure treated wood deck attached to the personal residence was completely destroyed by Hurricane Katrina. The personal-use residential real property is located in the Hurricane Katrina disaster area. The personal residence is 2,000 square feet and the personal-use residential real property does not contain any detached structure. The total square footage of the flooded rooms on the first floor is 1,000 square feet. Prior to Hurricane Katrina, the individual purchased the personal-use residential real property for $200,000. Insurance and other reimbursements total $90,000. The individual chooses to use the Cost Indexes Safe Harbor Method.

To calculate the decrease in fair market value of the personal-use residential real property, the individual uses the first column of Table 3 to determine the size of the personal residence based on the total square footage of the personal residence. The individual multiplies the flooded square footage of the personal residence, 1,000 square feet, by $92, the cost index for a Medium Personal Residence in column 2 of Table 3.

1,000 sq. ft. x $92/sq. ft. = 92,000

The wood deck is 200 square feet.

Using Table 7, the individual multiplies the square footage of the damaged area of the deck, 200 square feet, by the cost index of $15 in column 2 of Table 7.

200 sq. ft. x $15/sq. ft. = $3,000

To determine the total decrease in fair market value of the personal-use residential real property the individual adds $3,000 to $92,000.

$3,000 + $92,000 = $95,000

The individual then compares the adjusted basis of the personal-use residential real property, $200,000, to the decrease in fair market value determined by using the Cost Indexes Safe Harbor Method, $95,000. Since the decrease in fair market value of $95,000 is less than the basis of $200,000, the individual's casualty loss is $95,000. After subtracting $90,000, the amount of insurance and other reimbursements, from $95,000, the individual is entitled to a casualty loss deduction of $5,000 ($95,000 - $90,000 = $5,000).

Example 5. Prior to Hurricane Rita, an individual purchased personal-use residential real property for $200,000 and spent $5,000 for improvements to the personal-use residential real property. Two trees fell into the individual's personal residence during Hurricane Rita, destroying a portion of the roof. Rain from the hurricane soaked the walls and flooring of two bedrooms and the living room, necessitating removal and replacement of drywall and wood paneling, roof panels, trusses, and flooring. The rest of the personal residence remains undamaged. The personal residence was not flooded by salt water. Therefore, the damage constitutes structural damage from wind, rain, or debris, as described in section 3.05(4) of this revenue procedure. The individual's personal-use residential real property is located in the Hurricane Rita disaster area. The personal residence is 2,000 square feet and the personal-use residential real property does not contain any decking or detached structure. The damaged two bedrooms and living room total 1,000 square feet. Insurance and other reimbursements total $100,000.

The individual chooses to use the Cost Indexes Safe Harbor Method. Using Table 4, the percentage of square footage of the personal residence that was damaged by the hurricane is determined by dividing the total square footage of the personal residence by the square footage of the personal residence that was damaged as follows:

1,000 sq. ft. / 2,000 sq. ft. = 0.50 or 50% of the total square footage was damaged.

The individual uses the cost index in column 2 of Table 4 for 26% to 50% damage and multiplies it by the number of square feet that were damaged.

$132/sq. ft. x 1,000 sq. ft. = $132,000

The roof covering also sustained damage that necessitated replacement of all roof shingles, felt lining, and flashings. The total square footage of the ground floor of the personal residence is 2,000 square feet. The total square footage under the roof, including porches, patios, and overhangs, is 2,200 square feet. The individual multiplies the cost index for a Medium Personal Residence in Table 5 by 2,200 square feet, the total square footage under the roof.

2,200 sq. ft. x $5.75/sq. ft. = $12,650

The individual adds $12,650 to $132,000 to determine the total decrease in fair market value of the personal-use residential real property.

$12,650 + $132,000 = $144,650

The individual compares the decrease in fair market value, $144,650, with the adjusted basis, $205,000, and from the smaller of these two amounts, $144,650, subtracts insurance and other reimbursements of $100,000. The individual is entitled to a casualty loss deduction of $44,650 ($144,650 - $100,000 = $44,650).

Example 6. Winds from Hurricane Rita caused a tree to fall across a detached garage located on an individual's personal-use residential real property. Prior to Hurricane Rita, the individual purchased the personal-use residential real property for $200,000. The personal residence is located in the Hurricane Rita disaster area. The personal residence is not damaged by Hurricane Rita. The personal-use residential real property does not contain any decking or other detached structure. The garage suffered significant damage and requires major rebuilding. The total square footage of the garage is 400 square feet. The garage was not insured.

The individual chooses to use the Cost Indexes Safe Harbor Method. Because the garage is a detached structure, as described in section 3.05(6) of this revenue procedure, the individual uses Table 6 to determine the decrease in fair market value of the personal-use residential real property. Using Table 6, the individual multiplies the total square footage of the garage, 400 square feet, by the cost index of $38 in column 2 of Table 6.

400 sq. ft. x $38/sq. ft. = $15,200

The individual's basis in the personal-use residential real property is $200,000. The individual compares the decrease in fair market value, $15,200, with the basis, $200,000. Since the decrease in fair market value is less than the basis, the individual is entitled to a casualty loss deduction of $15,200.

Example 7. Winds from Hurricane Wilma blew down a pine tree that destroyed part of a pressure treated wooden deck attached to the back of an individual's personal residence. The personal-use residential real property is located in the Hurricane Wilma disaster area. The individual's basis in the personal-use residential real property is $200,000. Neither the personal residence nor any detached structure was damaged by the fallen tree. The deck is 450 square feet. It is necessary to rebuild one-half of the deck. The remaining half of the deck is not damaged, and remains structurally sound.

The individual chooses to use the Cost Indexes Safe Harbor Method. Because the deck is wood decking as described in section 3.05(7) of this revenue procedure, the individual uses Table 7 to determine the decrease in fair market value of the personal-use residential real property.

The square footage of the damaged area of the deck is one-half of 450 square feet, which is 225 square feet. Using Table 7, the individual multiplies the square footage of the damaged area of the deck, 225 square feet, by the cost index of $15 in column 2 of Table 7.

225 sq. ft. x $15/sq. ft. = $3,375

The individual compares the decrease in fair market value, $3,375, with the basis, $200,000. Since the decrease in fair market value is less than the basis, the individual is entitled to a casualty loss deduction of $3,375.

SECTION 6. REDUCTION FOR NO-COST REPAIRS

Under § 165(a), a casualty loss must be reduced by insurance or other amounts received, such as amounts given to an individual to repair the damage to the individual's property due to the casualty. This includes the value of repairs to, or rebuilding of, the individual's personal-use residential real property provided by another party at no cost to the individual ("no-cost repairs"), such as the repair or rebuilding of an individual's personal residence by volunteers. No-cost repairs include repairs made for a de minimis or token cost, donation, or gratuity.

An individual who uses the Cost Indexes Safe Harbor Method provided in section 4.04 of this revenue procedure to determine the decrease in the fair market value of the individual's personal-use residential real property must reduce the loss, determined using the Cost Indexes Safe Harbor Method, by the value of any no-cost repairs. For this purpose, the value of a no-cost repair is based upon the total square footage completely repaired at no cost to the individual. The total square footage completely repaired at no cost to the individual is multiplied by the same cost index the individual used to determine the decrease in the fair market value of the individual's personal-use residential real property. This amount is then subtracted from the loss determined under the Cost Indexes Safe Harbor Method.

SECTION 7. PERSONAL BELONGINGS SAFE HARBOR METHOD

.01 Certain personal belongings. Except as provided in section 7.02 of this revenue procedure, an individual may use the safe harbor method in this section 7.01 to determine the fair market value of the individual's personal belongings immediately before a 2005 Gulf hurricane in order to compute a casualty or theft loss. If an individual chooses to use the Personal Belongings Safe Harbor Method, the individual must apply that method to all personal belongings for which a loss is claimed under § 165 except those specifically excluded in section 7.02 of this revenue procedure.

To use this safe harbor method, an individual must first determine the current cost to replace the personal belonging with a new one and reduce that amount by 10% for each year the individual owned the personal belonging using the percentages in the Personal Belongings Valuation Table below. If the personal belonging was owned by the individual for nine or more years, the pre-hurricane fair market value is 10% of the current replacement cost under this safe harbor method.

Personal Belongings Valuation Table	
Year	Percentage of Replacement Cost to Use
1	90%
2	80%
3	70%
4	60%
5	50%
6	40%
7	30%
8	20%
9+	10%

To determine the casualty or theft loss deduction for personal belongings that were damaged, destroyed or stolen:

(1) Determine the decrease in the fair market value of each personal belonging by subtracting the fair market value of the personal belonging immediately after the hurricane from the fair market value of the personal belonging immediately before the hurricane, determined as described above. If a personal belonging was destroyed or stolen as a result of a 2005 Gulf hurricane its fair market value after the hurricane is zero.

(2) Determine the basis of each of the personal belongings (generally its cost).

(3) Compare the decrease in fair market value (from step 1) to the basis of the personal belonging (from step 2). From the lesser of the basis or decrease in fair market value, subtract any insurance or other reimbursements the individual receives or expects to receive for the personal belonging.

.02 Exclusions. An individual may not use the Personal Belongings Safe Harbor Method for a boat, aircraft, mobile home, trailer, vehicle, or an antique or other asset that maintains or increases its value over time. For purposes of this revenue procedure, a vehicle is an automobile, motorcycle, motor home, recreational vehicle, sport utility vehicle, off-road vehicle, van, or truck.

An individual may determine the pre-hurricane value of a boat, aircraft, mobile home, trailer, or vehicle by consulting established pricing sources. See Rev. Rul. 2002-67, 2002-2 C.B. 873.

.03 Example. An individual's personal belongings included a chair destroyed by Hurricane Wilma within the Hurricane Wilma disaster area. The individual purchased the chair for $70 four years prior to Hurricane Wilma. The cost to replace the chair with a new chair is $100. The chair is not insured.

Using the Personal Belongings Safe Harbor Method, the individual computes the fair market value of the chair immediately before the hurricane by multiplying the current replacement cost of the chair, $100, by the applicable percentage of replacement cost from the Personal Belongings Valuation table, 60%:

$$\$100 \times 60\% = \$60$$

The individual determines the decrease in the fair market value of the chair by subtracting $0, the fair market value of the chair immediately after the hurricane, from $60, the fair market value of the chair immediately before the hurricane.

$$\$60 - 0 = \$60$$

The individual compares the basis of $70 to the decrease in fair market value of $60. Since the decrease in fair market value is less than the basis, the individual is entitled to a casualty loss deduction of $60.

SECTION 8. EFFECTIVE DATE

This revenue procedure is effective for losses that arose in the (1) Hurricane Katrina disaster area on or after August 25, 2005, and are attributable to Hurricane Katrina; (2) Hurricane Rita disaster area on or after September 23, 2005, and are attributable to Hurricane Rita; and (3) Hurricane Wilma disaster area on or after October 23, 2005, and are attributable to Hurricane Wilma.

SECTION 9. REPORTING ON FORM 4684

Individuals who use one of the personal-use residential real property safe harbor methods provided in section 4 of this revenue procedure should attach a statement to Form 4684, Casualties and Thefts, stating that the individual used "Rev. Proc. 2006-32 to determine the individual's Hurricane Katrina, Rita, or Wilma (as applicable) casualty loss deduction and list the specific safe harbor method used, including the table numbers, where applicable (for example, "I/We used Rev. Proc. 2006-32 in determining my/our Hurricane Katrina casualty loss deduction using the Cost Indexes Safe Harbor Method, specifically Tables 3, 6, and 7."). Also, in completing Form 4684, if an individual uses any of the personal-use residential real property safe harbor methods in section 4 of this revenue procedure, for each of those properties do not enter an amount in line 5 or 6 and enter the decrease in fair market value determined under the safe harbor method on line 7 and mark "Revenue Procedure 2006-32" in red ink on the top of the Form 4684.

SECTION 10. PAPERWORK REDUCTION ACT

The collection of information contained in this revenue procedure has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545-0074. Please refer to the Paperwork Reduction Act statement accompanying Form 1040, U.S. Individual Income Tax Return, for further information.

DRAFTING INFORMATION

The principal author of this revenue procedure is Norma Rotunno of the Office of Associate Chief Counsel (Income Tax & Accounting). For further information regarding this revenue procedure, contact Ms. Rotunno at (202) 622-7900 or Sharon Hall at (202) 622-4950 (not a toll-free call).