20 T.C. 614 (1953)

When a taxpayer converts property from personal use to rental use, the basis for determining a loss upon a subsequent sale is the lesser of the property's fair market value at the time of conversion or its adjusted basis at that time.

Summary

Mae F. Meurer sought to deduct a capital loss on the sale of property previously used as a residence for her brother, later converted to rental property. The Tax Court initially denied the deduction due to a lack of evidence of the property's fair market value at the time of conversion. After a motion for rehearing, the court considered stipulated facts establishing the fair market value at conversion. The court then allowed the deduction, holding that the loss should be calculated using the fair market value at the time of conversion, less depreciation, compared to the net sale price.

Facts

Mae F. Meurer owned a property in Natick, Massachusetts, initially used as a residence for her ill brother, for whose welfare she was responsible. After her brother's death, Meurer converted the property to rental use in December 1929. She sold the property in 1944. Meurer claimed a capital loss on her tax return related to this sale.

Procedural History

The Tax Court initially denied Meurer's claimed loss deduction because she failed to provide evidence of the property's fair market value at the time it was converted to rental property. Meurer filed a motion for rehearing to present evidence of the fair market value at the time of conversion, which the Tax Court granted. The parties subsequently stipulated that the fair market value of the property was $20,000 on December 29, 1929, when it was converted to rental property.

Issue(s)

Whether the taxpayer is entitled to a capital loss deduction on the sale of property that was previously converted from personal use to rental use, where the fair market value of the property at the time of conversion is stipulated.

Holding

Yes, because the loss is calculated based on the difference between the net sale price and the adjusted basis of the property, using the fair market value at the time of conversion to rental use as the starting point for calculating basis.

Court's Reasoning

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The court relied on the stipulated facts that the property had a fair market value of $20,000 when converted to rental property in 1929. The court calculated the adjusted basis by subtracting depreciation from the fair market value at the time of conversion ($20,000 – $6,220 depreciation = $13,780 adjusted basis). It then determined the deductible loss by subtracting the net selling price from the adjusted basis ($13,780 – $10,180 net selling price = $3,600 loss). The court cited Section 117(J) of the Internal Revenue Code, although the opinion focuses on determining basis rather than interpreting that specific section. The court stated that Meurer was "entitled to a deduction for loss in the amount of the difference between the net sale price of the property herein involved and the adjusted basis of the fair market value of such property at the time of its conversion to commercial use."

Practical Implications

This case clarifies how to determine the basis for calculating a loss when property is converted from personal to rental use. Taxpayers must establish the fair market value of the property at the time of conversion to rental use. Practitioners should advise clients to obtain appraisals or other reliable evidence of fair market value at the time of conversion. This fair market value, less any depreciation taken, becomes the basis for determining gain or loss upon a subsequent sale. This rule prevents taxpayers from claiming inflated losses based on the original purchase price if the property's value has declined between the purchase and conversion dates. Subsequent cases may distinguish Meurer based on differing factual circumstances, such as situations where the conversion is deemed a sham transaction or where there is a lack of credible evidence of fair market value.

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