STATE OF ALABAMA, DEPARTMENT OF REVENUE, vs. WILLIAM AND EVA BUCHANAN 1801 Oak Drive Guntersville, AL 35976, Taxpayer.	§ § § § § §	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION DOCKET NO. INC. 92-245

FINAL ORDER

The Revenue Department assessed income tax against William and Eva Buchanan (Taxpayers) for the year 1988. The Taxpayers appealed to the Administrative Law Division and a hearing was conducted on October 7, 1992. William Buchanan attended the hearing for the Taxpayers. Assistant counsel Beth Acker represented the Department. The relevant facts are set out below.

The Taxpayers moved from Guntersville, Alabama to Winter Haven, Florida in 1985. The Taxpayers sold their personal residence in Guntersville when they moved and realized a $3,000.00 gain.

The Taxpayers purchased a new house in Winter Haven in 1985 for $115,000.00. There is no evidence indicating the fair market value of the house at that time. The Taxpayers paid $25,000.00 down and the seller financed the balance of $90,000.00.

The Taxpayers moved back to Guntersville in January, 1987 and put the Winter Haven house on the market at that time. The house was listed through a real estate agent for $127,500.00. While offering the house for sale, the Taxpayers leased the house for six months beginning in January, 1987, and again for a year beginning in July, 1987. Unfortunately, the second lessee moved out soon after signing the lease and the house remained empty until early 1988.

The Taxpayers were contacted by a second real estate agent in November, 1987 about selling the house. The second agent gave the Taxpayers an unsolicited "competitive market analysis" showing a suggested sales price of between $97,000.00 and $99,000.00.

The Taxpayers did not receive any offers on the house and subsequently sold the house back to the original seller in satisfaction of the outstanding $90,000.00 mortgage.

The Taxpayers claimed a $22,000.00 loss on the sale of the house, as follows:

$115,000.00	(basis)
- 3,000.00	(gain in Guntersville house)
112,000.00	(adjusted basis)
- 90,000.00	(sales price)
$ 22,000.00	(allowable loss)

The Department reduced the loss as follows:

$99,000.00	(basis)
-3,450.15	(1987 depreciation)
$95,549.85	(adjusted basis)
-90,000.00	(sales price)
$ 5,549.85	(allowable loss)

A loss on the sale of a personal residence is not deductible. However, if a personal residence is converted to rental property prior to being sold, any resulting loss is deductible.

Whether a personal residence is actually converted to business use must be decided on a case-by-case basis. A deduction was disallowed under circumstances similar to this case where the house was rented for only a limited time while the property was being offered for sale, E. Grohse, 27 TCM 220, and also where the house was listed with a real estate agent as "for sale or rent", T. Morgan, 35-1 USTC §9243, 76 F.2d 158. Nonetheless, the Department does not dispute that the house in this case was converted by the Taxpayers to business use.

The amount of a loss on property converted from personal to business use is the excess of the owner's adjusted basis in the property over the sales price. The adjusted basis is the lesser of the fair market value of the property or the owner's adjusted cost basis in the property at the time it was converted to business use.

The burden is on the Taxpayers in this case to establish the fair market value of the house at the time it was converted to business use. Heiner v. Tindle, 276 U. S. 582. The original cost basis of $115,000.00 cannot be used because there is no appraisal or other evidence indicating that the fair market value of the house was $115,000.00 either when the Taxpayers purchased the house in 1985, or importantly, when it was converted to business use in 1987. In the absence of an established fair market value above the sales price, no loss can be allowed. See, S.P. Robinson, 19 TCM 1374; D. S. Bugnolo, 30 TCM 611.

Nevertheless, the Department has assigned a fair market value of $99,000.00 based on the "competitive market analysis" dated November, 1987. The analysis was not performed by a competent appraiser and its accuracy is questionable. However, if that amount is not accepted as the property's fair market value at the time it was converted to business use, then the loss must be disallowed in full.

The above considered, the Department properly used $99,000.00 as the Taxpayers' tax basis in the house in issue. Accordingly, the assessment in issue as adjusted is affirmed and judgment is entered in favor of the Department and against the Taxpayers in the amount of $738.45, with additional interest computed from August 15, 1992.

This Final Order may be appealed to circuit court within 30 days pursuant to Code of Ala. 1975, §40-2A-9(g).

Entered on November 12, 1992.

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BILL THOMPSON
CHIEF ADMINISTRATIVE LAW JUDGE