

Tax Court Decision Underscores Risks in Converting Homes to Rentals

Tax Court ruling in Smith v. Commissioner highlights the risk of losing rental deductions without proper basis documentation.

COLORADO SPRINGS, CO, UNITED STATES, October 16, 2025

/EINPresswire.com/ -- A recent U.S. Tax Court opinion is drawing new attention to how homeowners handle the tax transition from personal use to rental property. In *Sherman Derrell Smith v. Commissioner*, T.C. Memo. 2025-24 (Mar. 24, 2025), the court disallowed depreciation deductions after the taxpayer failed to substantiate the property's basis at the time it became a rental.



Converting Your Primary Residence Into A Rental

The decision reinforces a technical but critical IRS rule: under Treasury Regulation 1.168(i)-4(b), the depreciable basis of a former home is the lower of its adjusted basis or fair market value on the date of conversion. Without documentation of that number, depreciation deductions can evaporate—a costly outcome for taxpayers counting on write-offs to offset rental income.

“

Taxpayers often focus on cash flow and overlook the paper trail. But basis drives depreciation—and the Tax Court just reminded us that ‘trust me’ isn’t documentation.”

Jason Watson, a real estate CPA and Partner at WCG CPAs & Advisors

WCG CPAs & Advisors recently revisited this topic in its educational article, [Converting a Primary Residence to a Rental](#), noting that conversions often occur for practical reasons such as preserving a favorable mortgage rate, deferring capital gains until a later year, or moving temporarily while awaiting market growth. The firm emphasizes, however, that tax details—not just financial timing—can make or break the outcome.

Among WCG's reminders for taxpayers:

- Verify and document fair market value at the time of conversion.
- Make major renovations after the property is placed in service to maximize depreciation opportunities.
- Understand potential tax arbitrage—losses on personal residences are not deductible, but post-conversion losses may be.

The Smith decision also underscores how small documentation gaps can turn into costly IRS disputes. A missing appraisal, an unsupported fair market value, or even casual recordkeeping can unravel years of claimed deductions. Once depreciation errors occur, they compound with each tax return, often triggering back taxes and accuracy penalties. WCG CPAs & Advisors, a team of [real estate CPAs](#), points out that conversions should be treated as formal business events, not casual moves—complete with contemporaneous valuations, basis worksheets, and detailed records. Doing so helps taxpayers protect legitimate deductions and demonstrate compliance if the IRS ever challenges their numbers.

For many homeowners, especially those relocating for work or military service, converting a residence into a rental remains an appealing strategy for long-term wealth building. But as the Smith case shows, even a seemingly routine conversion can stumble if basis documentation isn't in place.

About WCG CPAs & Advisors

WCG CPAs & Advisors is a full-service tax and accounting firm based in Colorado Springs, Colorado. Serving clients nationwide, WCG specializes in small-business taxation, [real estate investors](#) and rental property owners. Learn more at <https://wcginc.com>.

Jason Watson
WCG CPAs & Advisors
+1 719-387-9800
media@wcginc.com

This press release can be viewed online at: <https://www.einpresswire.com/article/857331334>

EIN Presswire's priority is source transparency. We do not allow opaque clients, and our editors try to be careful about weeding out false and misleading content. As a user, if you see something we have missed, please do bring it to our attention. Your help is welcome. EIN Presswire, Everyone's Internet News Presswire™, tries to define some of the boundaries that are reasonable in today's world. Please see our Editorial Guidelines for more information.

© 1995-2025 Newsmatics Inc. All Right Reserved.