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Reg. Section 1.165-9(b)(2)

Sale of Residential Property

(a) Losses not allowed. A loss sustained on the sale of residential property purchased or constructed by the taxpayer for use as his personal residence and so used by him up to the time of the sale is not deductible under section 165(a).

(b) Property converted from personal use.

(1) If property purchased or constructed by the taxpayer for use as his personal residence is, prior to its sale, rented or otherwise appropriated to income-producing purposes and is used for such purposes up to the time of its sale, a loss sustained on the sale of the property shall be allowed as a deduction under section 165(a).



(2) The loss allowed under this paragraph upon the sale of the property shall be the excess of the adjusted basis prescribed in § 1.1011-1 for determining loss over the amount realized from the sale. For this purpose, the adjusted basis for determining loss shall be the lesser of either of the following amounts, adjusted as prescribed in §1.1011-1 for the period subsequent to the conversion of the property to income-producing purposes:

(i) The fair market value of the property at the time of conversion, or

(ii) The adjusted basis for loss, at the time of conversion, determined under §1.1011-1 but without reference to the fair market value.

(3) For rules relating to casualty losses of property converted from personal use, see paragraph (a)(5) of §1.165-7. To determine the basis for depreciation in the case of such property, see §1.167(g)-1. For limitations on the loss from the sale of a capital asset, see paragraph (c)(3) of § 1.165-1.

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