

holder is the original purchaser who is issued stock of the Federal National Mortgage Association (FNMA) pursuant to section 303(c) of the Act and who appears on the books of FNMA as the initial holder. See §1.162-19.

(b) *Example.* The provisions of this section may be illustrated by the following example:

Example: Pursuant to section 303(c) of the Federal National Mortgage Association Charter Act a certificate of FNMA stock is issued to A as of January 1, 1961. The issuance price of the stock was \$100 and the fair market value of the stock on the date of issue was \$69. A was required by section 162(d) to treat \$31 as a business expense for the year 1961. The basis of the share of stock in the hands of A, the initial holder, shall be \$69, the amount paid for the stock (\$100) reduced by \$31.

[T.D. 6690, 28 FR 12254, Nov. 19, 1963]

§ 1.1055-1 General rule with respect to redeemable ground rents.

(a) *Character of a redeemable ground rent.* For purposes of subtitle A of the Code (1) a redeemable ground rent (as defined in section 1055(c) and paragraph (b) of this section) shall be treated as being in the nature of a mortgage, and (2) real property held subject to liabilities under such a redeemable ground rent shall be treated as held subject to liabilities under a mortgage. Thus, under section 1055(a) and this paragraph, the transfer of property subject to a redeemable ground rent has the same effect as the transfer of property subject to a mortgage, the acquisition of property subject to a redeemable ground rent is to be treated the same as the acquisition of property subject to a mortgage, and the holding of property subject to a redeemable ground rent is to be treated in the same manner as the holding of property subject to a mortgage. See section 163(c) for the treatment of any annual or periodic rental payment under a redeemable ground rent as interest.

(b) *Definition of redeemable ground rent.* For purposes of subtitle A of the Code, the term *redeemable ground rent* means only a ground rent with respect to which all the following conditions are met:

(1) There is a lease of land which is assignable by the lessee without the consent of the lessor.

(2) The term of the lease is for a period in excess of 15 years, taking into account all periods for which the lease may be renewed at the option of the lessee.

(3) The lessee has a present or future right to terminate the lease and to acquire the lessor's interest in the land (i.e., to redeem the ground rent) by the payment of a determined or determinable amount, which amount is referred to in §§1.1055-2, 1.1055-3, and 1.1055-4 as a *redemption price*. Such right must exist by virtue of State or local law. If the lessee's right to terminate the lease and to acquire the lessor's interest is not granted by State or local law but exists solely by virtue of a private agreement or privately created condition, the ground rent is not a *redeemable ground rent*.

(4) The lessor's interest in the land subject to the lease is primarily a security interest to protect the payment to him of the annual or periodic rental payments due under the lease.

(c) *Effective date.* In general, the provisions of section 1055 and paragraph (a) of this section take effect on April 11, 1963, and apply with respect to taxable years ending on or after such date. See §1.1055-3 for rules for determining the basis of real property acquired subject to liabilities under a redeemable ground rent regardless of when such property was acquired. See also §1.1055-4 for rules for determining the basis of a redeemable ground rent in the hands of a holder who reserved or created such ground rent in connection with a transfer, occurring before April 11, 1963, of the right to hold real property subject to liabilities under such ground rent.

[T.D. 6821, 30 FR 6216, May 4, 1965]

§ 1.1055-2 Determination of amount realized on the transfer of the right to hold real property subject to liabilities under a redeemable ground rent.

In determining the amount realized from a transfer, occurring on or after April 11, 1963, of the right to hold real property subject to liabilities under a redeemable ground rent, such ground rent shall be accounted for in the same manner as a mortgage for an amount of money equal to the redemption price of

§ 1.1055-3

the ground rent. The provisions of this section apply in respect of any such transfer even though such ground rent was created prior to April 11, 1963. For provisions relating to the determination of the amount of and recognition of gain or loss from the sale or other disposition of property, see section 1001 and the regulations thereunder.

[T.D. 6821, 30 FR 6217, May 4, 1965]

§ 1.1055-3 Basis of real property held subject to liabilities under a redeemable ground rent.

(a) *In general.* The provisions of section 1055(a) and paragraph (a) of § 1.1055-1 are applicable in determining the basis of real property held on or after April 11, 1963, in any case where the property at the time of acquisition was subject to liabilities under a redeemable ground rent. (See section 1055(b)(2).) Thus, if on or after April 11, 1963, a taxpayer holds real property which was subject to liabilities under a redeemable ground rent at the time he acquired it, the basis of such property in the hands of such taxpayer, regardless of when the property was acquired, will include the redeemable ground rent in the same manner as if it were a mortgage in an amount equal to the redemption price of such ground rent. Likewise, if on or after April 11, 1963, a taxpayer holds real property which was subject to liabilities under a redeemable ground rent at the time he acquired it and which has a substituted basis in his hands, the basis of the property in the hands of the taxpayer's predecessor in interest is to be determined by treating the redeemable ground rent in the same manner as a mortgage in an amount equal to the redemption price of such ground rent.

(b) *Illustrations.* The provisions of this section may be illustrated by the following examples:

Example 1. On April 11, 1963, taxpayer A held residential property which he acquired on January 15, 1963, for a purchase price of \$10,000 and which, at the time he acquired it, was subject to a ground rent redeemable for a redemption price of \$1,600. A's basis for the property includes the purchase price (\$10,000) plus the redeemable ground rent in the same manner as if it were a mortgage for \$1,600.

Example 2. In 1962, taxpayer X, a corporation, acquired real property subject to a redeemable ground rent in a transfer to which

26 CFR Ch. I (4-1-09 Edition)

section 351 (relating to transfer of property to corporation controlled by transferor) applied and in which the basis of the property to X was the transferor's basis. X still held the property on April 11, 1963. The transferor's basis in the property is to be determined by treating the redeemable ground rent to which it was subject in the transferor's hands as if it were a mortgage.

[T.D. 6821, 30 FR 6217, May 4, 1965]

§ 1.1055-4 Basis of redeemable ground rent reserved or created in connection with transfers of real property before April 11, 1963.

(a) *In general.* In the case of a redeemable ground rent created or reserved in connection with a transfer, occurring before April 11, 1963, of the right to hold real property subject to liabilities under such ground rent, the basis of such ground rent on or after April 11, 1963, in the hands of the person who reserved or created the ground rent is the amount which was taken into account in respect of such ground rent in computing the amount realized from the transfer of such real property. Thus, if no such amount was taken into account, such basis shall be determined without regard to section 1055. (See section 1055(b)(3).)

(b) The provisions of this section may be illustrated by the following examples:

Example 1. The taxpayer, who was in the business of building houses, purchased an undeveloped lot of land for \$500 and built a house thereon at a cost of \$10,000. Subsequently, he transferred the right to hold the lot improved by the house for a consideration of \$12,000, and an annual ground rent for such property of \$120 which was redeemable for a redemption price of \$2,000. The taxpayer reported a \$2,000 gain on the transfer, treating the amount realized as \$12,000 and his cost allocable to the interest transferred as \$10,000. Since the builder did not take the redeemable ground rent into account in computing gain on the transfer, his basis for such ground rent is \$500 (the cost of the land not offset against the consideration received for the transfer). Thus, if he subsequently sells the redeemable ground rent (or if it is redeemed from him) for \$2,000, he has no gain of \$1,500 in the year of sale (or redemption).

Example 2. Assume the same facts as in Example 1 except that the builder reported a gain of \$3,500 on the transfer, treating the amount realized as \$14,000 (\$12,000 cash plus \$2,000 for the redeemable ground rent) and his costs as \$10,500 (\$10,000 for the house and \$500 for the lot). Since the taxpayer took the