

under section 108(b)(2)(E). Similar principles apply, with appropriate adjustments, if S and B are members of a controlled group and S's loss is deferred only under section 267(f).

(b) *Effective date.* This section applies with respect to discharges of indebtedness occurring on or after September 11, 1995.

[T.D. 8597, 60 FR 36680, July 18, 1995]

§ 1.108-4 Election to reduce basis of depreciable property under section 108(b)(5) of the Internal Revenue Code .

(a) *Description.* An election under section 108(b)(5) is available whenever a taxpayer excludes discharge of indebtedness income (COD income) from gross income under sections 108(a)(1)(A), (B), or (C) (concerning title 11 cases, insolvency, and qualified farm indebtedness, respectively). See sections 108(d)(2) and (3) for the definitions of *title 11 case* and *insolvent*. See section 108(g)(2) for the definition of *qualified farm indebtedness*.

(b) *Time and manner.* To make an election under section 108(b)(5), a taxpayer must enter the appropriate information on Form 982, *Reduction of Tax Attributes Due to Discharge of Indebtedness (and Section 1082 Basis Adjustment)*, and attach the form to the timely filed (including extensions) Federal income tax return for the taxable year in which the taxpayer has COD income that is excluded from gross income under section 108(a). An election under this section may be revoked only with the consent of the Commissioner.

(c) *Effective date.* This section applies to elections concerning discharges of indebtedness occurring on or after October 22, 1998.

[T.D. 8787, 63 FR 56562, Oct. 22, 1998]

§ 1.108-5 Time and manner for making election under the Omnibus Budget Reconciliation Act of 1993.

(a) *Description.* Section 108(c)(3)(C), as added by section 13150 of the Omnibus Budget Reconciliation Act of 1993 (Pub. L. 103-66, 107 Stat. 446), allows certain noncorporate taxpayers to elect to treat certain indebtedness described in section 108(c)(3) that is discharged after December 31, 1992, as qualified real property business indebtedness. This

discharged indebtedness is excluded from gross income to the extent allowed by section 108.

(b) *Time and manner for making election.* The election described in this section must be made on the timely-filed (including extensions) Federal income tax return for the taxable year in which the taxpayer has discharge of indebtedness income that is excludable from gross income under section 108(a). The election is to be made on a completed Form 982, in accordance with that Form and its instructions.

(c) *Revocability of election.* The election described in this section is revocable with the consent of the Commissioner.

(d) *Effective date.* The rules set forth in this section are effective December 27, 1993.

[T.D. 8688, 61 FR 65322, Dec. 12, 1996. Redesignated by T.D. 8787, 63 FR 56563, Oct. 22, 1998]

§ 1.108-6 Limitations on the exclusion of income from the discharge of qualified real property business indebtedness.

(a) *Indebtedness in excess of value.* With respect to any qualified real property business indebtedness that is discharged, the amount excluded from gross income under section 108(a)(1)(D) (concerning discharges of qualified real property business indebtedness) shall not exceed the excess, if any, of the outstanding principal amount of that indebtedness immediately before the discharge over the net fair market value of the qualifying real property, as defined in § 1.1017-1(c)(1), immediately before the discharge. For purposes of this section, *net fair market value* means the fair market value of the qualifying real property (notwithstanding section 7701(g)), reduced by the outstanding principal amount of any qualified real property business indebtedness (other than the discharged indebtedness) that is secured by such property immediately before and after the discharge. Also, for purposes of section 108(c)(2)(A) and this section, outstanding principal amount means the principal amount of indebtedness together with all additional amounts owed that, immediately before the discharge, are equivalent to principal, in that interest on such amounts would

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accrue and compound in the future, except that outstanding principal amount shall not include amounts that are subject to section 108(e)(2) and shall be adjusted to account for unamortized premium and discount consistent with section 108(e)(3).

(b) *Overall limitation.* The amount excluded from gross income under section 108(a)(1)(D) shall not exceed the aggregate adjusted bases of all depreciable real property held by the taxpayer immediately before the discharge (other than depreciable real property acquired in contemplation of the discharge) reduced by the sum of any—

(1) Depreciation claimed for the taxable year the taxpayer excluded discharge of indebtedness from gross income under section 108(a)(1)(D); and

(2) Reductions to the adjusted bases of depreciable real property required under section 108(b) or section 108(g) for the same taxable year.

(c) *Effective date.* This section applies to discharges of qualified real property business indebtedness occurring on or after October 22, 1998.

[T.D. 8787, 63 FR 56563, Oct. 22, 1998]

§ 1.108(c)-1T [Reserved]

§ 1.109-1 Exclusion from gross income of lessor of real property of value of improvements erected by lessee.

(a) Income derived by a lessor of real property upon the termination, through forfeiture or otherwise, of the lease of such property and attributable to buildings erected or other improvements made by the lessee upon the leased property is excluded from gross income. However, where the facts disclose that such buildings or improvements represent in whole or in part a liquidation in kind of lease rentals, the exclusion from gross income shall not apply to the extent that such buildings or improvements represent such liquidation. The exclusion applies only with respect to the income realized by the lessor upon the termination of the lease and has no application to income, if any, in the form of rent, which may be derived by a lessor during the period of the lease and attributable to buildings erected or other improvements made by the lessee. It has no application to income which may be realized

by the lessor upon the termination of the lease but not attributable to the value of such buildings or improvements. Neither does it apply to income derived by the lessor subsequent to the termination of the lease incident to the ownership of such buildings or improvements.

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

Example. The A Corporation leased in 1945 for a period of 50 years unimproved real property to the B Corporation under a lease providing that the B Corporation erect on the leased premises an office building costing \$500,000, in addition to paying the A Corporation a lease rental of \$10,000 per annum beginning on the date of completion of the improvements, the sum of \$100,000 being placed in escrow for the payment of the rental. The building was completed on January 1, 1950. The lease provided that all improvements made by the lessee on the leased property would become the absolute property of the A Corporation on the termination of the lease by forfeiture or otherwise and that the lessor would become entitled on such termination to the remainder of the sum, if any, remaining in the escrow fund. The B Corporation forfeited its lease on January 1, 1955, when the improvements had a value of \$100,000. Under the provisions of section 109, the \$100,000 is excluded from gross income. The amount of \$50,000 representing the remainder in the escrow fund is forfeited to the A Corporation and is included in the gross income of that taxpayer. As to the basis of the property in the hands of the A Corporation, see § 1.1019-1.

§ 1.110-1 Qualified lessee construction allowances.

(a) *Overview.* Amounts provided to a lessee by a lessor for property to be constructed and used by the lessee pursuant to a lease are not includible in the lessee's gross income if the amount is a qualified lessee construction allowance under paragraph (b) of this section.

(b) *Qualified lessee construction allowance*—(1) *In general.* A qualified lessee construction allowance means any amount received in cash (or treated as a rent reduction) by a lessee from a lessor—

(i) Under a short-term lease of retail space;

(ii) For the purpose of constructing or improving qualified long-term real