

certain deferred payments, see section 483 and the regulations thereunder.

(b) Interest paid by the taxpayer on a mortgage upon real estate of which he is the legal or equitable owner, even though the taxpayer is not directly liable upon the bond or note secured by such mortgage, may be deducted as interest on his indebtedness. Pursuant to the provisions of section 163(c), any annual or periodic rental payment made by a taxpayer on or after January 1, 1962, under a redeemable ground rent, as defined in section 1055(c) and paragraph (b) of § 1.1055-1, is required to be treated as interest on an indebtedness secured by a mortgage and, accordingly, may be deducted by the taxpayer as interest on his indebtedness. Section 163(c) has no application in respect of any annual or periodic rental payment made prior to January 1, 1962, or pursuant to an arrangement which does not constitute a "redeemable ground rent" as defined in section 1055(c) and paragraph (b) of § 1.1055-1. Accordingly, annual or periodic payments of Pennsylvania ground rents made before, on, or after January 1, 1962, are deductible as interest if the ground rent is redeemable. An annual or periodic rental payment under a Maryland redeemable ground rent made prior to January 1, 1962, is deductible in accordance with the rules and regulations applicable at the time such payment was made. Any annual or periodic rental payment under a Maryland redeemable ground rent made by the taxpayer on or after January 1, 1962, is, pursuant to the provisions of section 163(c), treated as interest on an indebtedness secured by a mortgage and, accordingly, is deductible by the taxpayer as interest on his indebtedness. In any case where the ground rent is irredeemable, any annual or periodic ground rent payment shall be treated as rent and shall be deductible only to the extent that the payment constitutes a proper business expense. Amounts paid in redemption of a ground rent shall not be treated as interest. For treatment of redeemable ground rents and real property held subject to liabilities under redeemable ground rents, see section 1055 and the regulations thereunder.

(c) Interest calculated for costkeeping or other purposes on ac-

count of capital or surplus invested in the business which does not represent a charge arising under an interest-bearing obligation, is not an allowable deduction from gross income. Interest paid by a corporation on scrip dividends is an allowable deduction. So-called interest on preferred stock, which is in reality a dividend thereon, cannot be deducted in computing taxable income. (See, however, section 583.) In the case of banks and loan or trust companies, interest paid within the year on deposits, such as interest paid on moneys received for investment and secured by interest-bearing certificates of indebtedness issued by such bank or loan or trust company, may be deducted from gross income.

(d) To the extent of assistance payments made in respect of an indebtedness of the taxpayer during the taxable year by the Department of Housing and Urban Development under section 235 of the National Housing Act (12 U.S.C. 1715z), as amended, no deduction shall be allowed under section 163 and this section for interest paid or accrued with respect to such indebtedness. However, such payments shall not affect the amount of any deduction under any section of the Code other than section 163. The provisions of this paragraph shall apply to taxable years beginning after December 31, 1974.

[T.D. 6500, 25 FR 11402, Nov. 26, 1960, as amended by T.D. 6821, 30 FR 6216, May 4, 1965; T.D. 6873, 31 FR 941, Jan. 25, 1966; T.D. 7408, 41 FR 9547, Mar. 5, 1976]

§ 1.163-2 Installment purchases where interest charge is not separately stated.

(a) *In general.* (1) Whenever there is a contract with a seller for the purchase of personal property providing for payment of part or all of the purchase price in installments and there is a separately stated carrying charge (including a finance charge, service charge, and the like) but the actual interest charge cannot be ascertained, a portion of the payments made during the taxable year under the contract shall be treated as interest and is deductible under section 163 and this section. Section 163(b) contains a formula, described in paragraph (b) of this section, in accordance with which the amount

of interest deductible in the taxable year must be computed. This formula is designed to operate automatically in the case of any installment purchase, without regard to whether payments under the contract are made when due or are in default. For applicable limitations when an obligation to pay is terminated, see paragraph (c) of this section.

(2) Whenever there is a contract with an educational institution for the purchase of educational services providing for payment of part or all of the purchase price in installments and there is a separately stated carrying charge (including a finance charge, service charge, and the like) but the actual interest charge cannot be ascertained, a portion of the payments made during the taxable year under the contract shall be treated as interest and is deductible under section 163 and this section. See paragraphs (b) and (c) of this section for the applicable computation and limitations rules. For purposes of section 163(b) and this section, the term "educational services" means any service (including lodging) which is purchased from an educational institution (as defined in section 151(e)(4) and paragraph (c) of §1.151-3) and which is provided for a student of such institution.

(3) Section 163(b) and this section do not apply to a contract for the loan of money, even if the loan is to be repaid in installments and even if the borrowed amount is used to purchase personal property or educational services. In cases to which the preceding sentence applies, the portion of the installment payment which constitutes interest (as distinguished from payments of principal and charges such as payments for credit life insurance) is deductible under section 163(a) and §1.163-1.

(b) *Computation.* The portion of any such payments to be treated as interest shall be equal to 6 percent of the average unpaid balance under the contract during the taxable year. For purposes of this computation, the average unpaid balance under the contract is the sum of the unpaid balance outstanding on the first day of each month beginning during the taxable year, divided by 12.

(c) *Limitations.* The amount treated as interest under section 163(b) and this section for any taxable year shall not exceed the amount of the payments made under the contract during the taxable year nor the aggregate carrying charges properly attributable to each contract for such taxable year. In computing the amount to be treated as interest if the obligation to pay is terminated as, for example, in the case of a repossession of the property, the unpaid balance on the first day of the month during which the obligation is terminated shall be zero.

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

Example (1). On January 20, 1955, A purchased a television set for \$400, including a stated carrying charge of \$25. The down payment was \$50, and the balance was paid in 14 monthly installments of \$25 each, on the 20th day of each month commencing with February. Assuming that A is a cash method, calendar year taxpayer and that no other installment purchases were made, the amount to be treated as interest in 1955 is \$12.38, computed as follows:

YEAR 1955	
First day of	Unpaid balance outstanding
January	0
February	\$350
March	325
April	300
May	275
June	250
July	225
August	200
September	175
October	150
November	125
December	100
	2,475

Sum of unpaid balances $\$2,475 \div 12 = \206.25 ; 6 percent thereof = \$12.38.

Example (2). On November 20, 1955, B purchased a furniture set for \$1,250, including a stated carrying charge of \$48. The down payment was \$50 and the balance was payable in 12 monthly installments of \$100 each, on the first day of each month commencing with December 1955. Assume that B is a cash method, calendar year taxpayer and that no other installment purchases were made. Assume further that B made the first payment when due, but made only one other payment

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on June 1, 1956. The amount to be treated as interest in 1955 is \$4, and the amount to be treated as interest in 1956 is \$33, computed as follows:

YEAR 1955	
First day of	Unpaid balance outstanding
December	\$1,200

Sum of unpaid balances $\$1,200 \div 12 = \100 ; 6 percent thereof = \$6.
 Carrying charges attributable to 1955 = \$4.

YEAR 1956	
First day of	Unpaid balance outstanding
January	\$1,100
February	1,000
March	900
April	800
May	700
June	600
July	500
August	400
September	300
October	200
November	100
	6,600

Sum of unpaid balances $\$6,600 \div 12 = \550 ; 6 percent thereof = \$33.
 Carrying charges attributable to 1956 = \$44 (\$4×11).

Example (3). Assume the same facts as in example (2), except that the furniture was repossessed and B's obligation to pay terminated as of July 15, 1956. The amount to be treated as interest in 1955 is \$4, computed as in example (2) above. The amount to be treated as interest in 1956 is \$25.50, computed as follows:

YEAR 1956	
First day of	Unpaid balance outstanding
January	\$1,100
February	1,000
March	900
April	800
May	700
June	600
July–November	0
	5,100

Sum of unpaid balances $\$5,100 \div 12 = \425 . 6 percent thereof = \$25.50.

Carrying charges attributable to 1956 = \$44 (\$4×11).

Example (4). (i) On September 15, 1968, C registered at X University for the 1968-69 academic year. C entered into an agreement with the X University for the purchase during such academic year of educational services (including lodging and tuition) for a total fee of \$1,000, including a separately stated carrying charge of \$50. Under the terms of the agreement, an initial payment of \$200 was to be made by C on September 15, 1968, and the balance was to be paid in 8 monthly installments of \$100 each, on the 15th day of each month commencing with October 1968. C made all of the required 1968 payments. Assuming that C is a cash method, calendar year taxpayer and that no other installment purchases of services or property were made, the amount to be treated as interest in 1968 is \$10.50, computed as follows:

YEAR 1968	
First day of	Unpaid balance outstanding
January–September	0
October	\$800
November	700
December	600
Total	2,100

The sum of unpaid balances (\$2,100) divided by 12 is \$175; 6 percent thereof is \$10.50. The carrying charges attributable to 1968 are \$18.75 (i.e., the total carrying charges (\$50), divided by the total number of payments (8), multiplied by the number of payments made in 1968 (3)). Since the amount to be treated as interest in 1968 (\$10.50) does not exceed the carrying charges attributable to 1968 (\$18.75), the limitation set forth in paragraph (c) of this section is not applicable.

(ii) The result in this example would be the same even if the X University assigned the agreement to a bank or other financial institution and C made his payments directly to the bank or other financial institution.

Example (5). On September 15, 1968, D registered at Y University for the 1968-69 academic year. The tuition for such year was \$1,500. In order to pay his tuition, D borrowed \$1,500 from the M Corporation, a lending institution, and remitted that sum to the Y University. The loan agreement between M Corporation and D provided that D was to repay the loan, plus a service charge, in 10 equal monthly installments, on the first day of each month commencing with October 1968. The service charge consisted of interest and the cost of credit life insurance on D's

life. Since section 163(b) and this section do not apply to a contract for the loan of money, D is not entitled to compute his interest deduction with respect to his loan from M Corporation under such sections. D may deduct that portion of each installment payment which constitutes interest (as distinguished from payments of principal and the charge for credit life insurance) under section 163(a) and § 1.163-1, provided that the amount of such interest can be ascertained.

(e) *Effective date.* Except in the case of payments made under a contract for educational services, the rule provided in section 163(b) and this section applies to payments made during taxable years beginning after December 31, 1953, and ending after August 16, 1954, regardless of when the contract of sale was made. In the case of payments made under a contract for educational services, the rule provided in section 163(b) and this section applies to payments made during taxable years beginning after December 31, 1963, regardless of when the contract for educational services was made.

[T.D. 6500, 25 FR 11402, Nov. 26, 1960, as amended by T.D. 6991, 34 FR 742, Jan. 17, 1969]

§ 1.163-3 Deduction for discount on bond issued on or before May 27, 1969.

(a) *Discount upon issuance.* (1) If bonds are issued by a corporation at a discount, the net amount of such discount is deductible and should be prorated or amortized over the life of the bonds. For purposes of this section, the amortizable bond discount equals the excess of the amount payable at maturity (or, in the case of a callable bond, at the earlier call date) over the issue price of the bond (as defined in paragraph (b)(2) of § 1.1232-3).

(2) In the case of a bond issued by a corporation after December 31, 1954, as part of an investment unit consisting of an obligation and an option, the issue price of the bond is determined by allocating the amount received for the investment unit to the individual elements of the unit in the manner set forth in subdivision (ii)(a) of § 1.1232-3(b)(2). Discount with respect to bonds issued by a corporation as part of investment units consisting of obligations and options after December 31, 1954, and before Dec. 24, 1968—

(i) Increased by any amount treated as bond premium which has been included in gross income with respect to such bonds prior to Dec. 24, 1968, or

(ii) Decreased by any amount which has been deducted by the issuer as discount attributable to such bonds prior to Dec. 24, 1968, and

(iii) Decreased by any amount which has been deducted by the issuer prior to Dec. 24, 1968 upon the exercise or sale by investors of options issued in investment units with such bonds,

should be amortized, starting with the first taxable year ending on or after Dec. 24, 1968 over the remaining life of such bonds.

(b) *Examples.* The rules in paragraph (a) of this section are illustrated by the following examples:

Example (1). M Corporation, on January 1, 1960, the beginning of its taxable year issued for \$95,000, 3 percent bonds, maturing 10 years from the date of issue, with a stated redemption price at maturity of \$100,000. M Corporation should treat \$5,000 (\$100,000-\$95,000) as the total amount to be amortized over the life of the bonds.

Example (2). Assume the same facts as example (1), except that the bonds are convertible into common stock of M Corporation. Since the issue price of the bonds includes any amount attributable to the conversion privilege, the result is the same as in example (1).

Example (3). Assume the same facts as example (1), except that the bonds are issued as part of an investment unit consisting of an obligation and an option. Assume further that the issue price of the bonds as determined under the rules of allocation set forth in subdivision (ii)(a) of § 1.1232-3(b)(2) is \$94,000. Accordingly, M Corporation should treat \$6,000 (\$100,000-\$94,000) as the total amount to be amortized over the life of the bonds.

Example (4). Assume in example (3), that prior to Dec. 24, 1968, M Corporation had only treated \$5,000 as the bond discount to be amortized and deducted only \$4,000 of this amount. Starting with the first taxable year ending on or after Dec. 24, 1968, M Corporation should amortize \$2,000 (\$6,000 discount, less \$4,000 previously deducted) over the remaining life of the bonds.

Example (5). N Corporation, on January 1, 1956, for a consideration of \$102,000, issued 20-year bonds in the face amount of \$100,000, together with options to purchase stock of N Corporation. The issue price of the bonds as determined under the rules of allocation set forth in subdivision (ii)(a) of § 1.1232-3(b)(2) is \$99,000. Until Dec. 24, 1968, N Corporation has