

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 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 redeem-

able 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 entire amount of the redeemable ground rent into account in computing his gain, his basis for such ground rent is \$2,000. Thus, if he subsequently sells the redeemable ground rent (or if it is redeemed from him) for \$2,000, he has no gain or loss on the transaction.

Example 3. Assume the same facts as in Example 1 except that the builder reported a gain of \$3,000 on the transfer. He computed this gain by treating the amount realized as \$12,000 but treating his cost allocable to the interest transferred as \$12,000/\$14,000ths of his total \$10,500 cost, or \$9,000. Since the builder still has remaining \$1,500 of unallocated cost, his basis for the redeemable ground rent is \$1,500. Thus, if he subsequently sells the redeemable ground rent (or if it is redeemed from him) for \$2,000, he has a gain of \$500 in the year of sale (or redemption).

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§ 1.1059(e)-1 Non-pro rata redemptions.

(a) *In general.* Section 1059(d)(6) (exception where stock held during entire existence of corporation) and section 1059(e)(2) (qualifying dividends) do not apply to any distribution treated as an extraordinary dividend under section 1059(e)(1). For example, if a redemption of stock is not pro rata as to all shareholders, any amount treated as a dividend under section 301 is treated as an extraordinary dividend regardless of whether the dividend is a qualifying dividend.

(b) *Reorganizations.* For purposes of section 1059(e)(1), any exchange under section 356 is treated as a redemption and, to the extent any amount is treated as a dividend under section 356(a)(2),