

(ii) *Exception.* For taxable years beginning after October 4, 1976, section 856(d)(4) provides an exception to the general rule that amounts received or accrued, directly or indirectly, by a real estate investment trust do not qualify as rents from real property if the determination of the amount depends in whole or in part on the income or profits derived by any person from the property. This exception applies where the trust rents property to a tenant (the prime tenant) for a rental which is based, in whole or in part, on a fixed percentage or percentages of the receipts or sales of the prime tenant, and the rent which the trust receives or accrues from the prime tenant pursuant to the lease would not qualify as "rents from real property" solely because the prime tenant receives or accrues from subtenants (including concessionaires) rents or other amounts based on the income or profits derived by a person from the property. Under the exception, only a proportionate part of the rent received or accrued by the trust does not qualify as "rents from real property". The proportionate part of the rent received or accrued by the trust which is non-qualified is the lesser of the following two amounts:

(A) The rent received or accrued by the trust from the prime tenant pursuant to the lease, that is based on a fixed percentage or percentages of receipts or sales, or

(B) The product determined by multiplying the total rent which the trust receives or accrues from the prime tenant pursuant to the lease by a fraction, the numerator of which is the rent or other amount received by the prime tenant that is based, in whole or in part, on the income or profits derived by any person from the property, and the denominator of which is the total rent or other amount received by the prime tenant from the property. For example, assume that a real estate investment trust owns land underlying a shopping center. The trust rents the land to the owner of the shopping center for an annual rent of \$10x plus 2 percent of the gross receipts which the prime tenant receives from subtenants who lease space in the shopping center. Assume further that, for the year in

question, the prime tenant derives total rent from the shopping center of \$100x and, of that amount, \$25x is received from subtenants whose rent is based, in whole or in part, on the income or profits derived from the property. Accordingly, the trust will receive a total rent of \$12x, of which \$2x is based on a percentage of the gross receipts of the prime tenant. The portion of the rent which is disqualified is the lesser of \$2x (the rent received by the trust which is based on a percentage of gross receipts), or \$3x, (\$12x multiplied by \$25x/\$100x). Accordingly, \$10x of the rent received by the trust qualifies as "rents from real property" and \$2x does not qualify.

(7) *Attribution rules.* Paragraphs (2) and (3) of section 856(d) relate to direct or indirect ownership of stock, assets, or net profits by the persons described therein. For purposes of determining such direct or indirect ownership, the rules prescribed by section 318(a) (for determining the ownership of stock) shall apply except that "10 percent" shall be substituted for "50 percent" in section 318(a) (2)(C) and (3)(C).

(Sec. 856(d)(4) (90 Stat. 1750; 26 U.S.C. 856(d)(4)); sec. 856(e)(5) (88 Stat. 2113; 26 U.S.C. 856(e)(5)); sec. 856(f)(2) (90 Stat. 1751; 26 U.S.C. (856(f)(2)); sec. 856(g)(2) (90 Stat. 1753; 26 U.S.C. 856(g)(2)); sec. 858(a) (74 Stat. 1008; 26 U.S.C. 858(a)); sec. 859(c) (90 Stat. 1743; 26 U.S.C. 859(c)); sec. 859(e) (90 Stat. 1744; 26 U.S.C. 859(e)); sec. 6001 (68A Stat. 731; 26 U.S.C. 6001); sec. 6011 (68A Stat. 732; 26 U.S.C. 6011); sec. 6071 (68A Stat. 749; 26 U.S.C. 6071); sec. 6091 (68A Stat. 752; 26 U.S.C. 6091); sec. 7805 (68A Stat. 917; 26 U.S.C. 7805), Internal Revenue Code of 1954)

[T.D. 6598, 27 FR 4085, Apr. 28, 1962, as amended by T.D. 6969, 33 FR 12000, Aug. 23, 1968; T.D. 7767, 46 FR 11266, Feb. 6, 1981]

#### § 1.856-5 Interest.

(a) *In general.* In computing the percentage requirements in section 856(c) (2)(B) and (3)(B), the term "interest" includes only an amount which constitutes compensation for the use or forbearance of money. For example, a fee received or accrued by a lender which is in fact a charge for services performed for a borrower rather than a charge for the use of borrowed money is not includable as interest.

(b) *Where amount depends on income or profits of any person.* Except as provided

in paragraph (d) of this section, any amount received or accrued, directly or indirectly, with respect to an obligation is not includable as interest for purposes of section 856(c) (2)(B) and (3)(B) if, under the principles set forth in paragraphs (b)(3) and (6)(i) of § 1.856-4, the determination of the amount depends in whole or in part on the income or profits of any person (whether or not derived from property secured by the obligation). Thus, for example, if in accordance with a loan agreement an amount is received or accrued by the trust with respect to an obligation which includes both a fixed amount of interest and a percentage of the borrower's income or profits, neither the fixed interest nor the amount based upon the percentage will qualify as interest for purposes of section 856(c) (2)(B) and (3)(B). This paragraph and paragraph (d) of this section apply only to amounts received or accrued in taxable years beginning after October 4, 1976, pursuant to loans made after May 27, 1976. For purposes of the preceding sentence, a loan is considered to be made before May 28, 1976, if it is made pursuant to a binding commitment entered into before May 28, 1976.

(c) *Apportionment of interest*—(1) *In general.* Where a mortgage covers both real property and other property, an apportionment of the interest income must be made for purposes of the 75-percent requirement of section 856(c)(3). For purposes of the 75-percent requirement, the apportionment shall be made as follows:

(i) If the loan value of the real property is equal to or exceeds the amount of the loan, then the entire interest income shall be apportioned to the real property.

(ii) If the amount of the loan exceeds the loan value of the real property, then the interest income apportioned to the real property is an amount equal to the interest income multiplied by a fraction, the numerator of which is the loan value of the real property, and the denominator of which is the amount of the loan. The interest income apportioned to the other property is an amount equal to the excess of the total interest income over the interest income apportioned to the real property.

(2) *Loan value.* For purposes of this paragraph, the loan value of the real property is the fair market value of the property, determined as of the date on which the commitment by the trust to make the loan becomes binding on the trust. In the case of a loan purchased by the trust, the loan value of the real property is the fair market value of the property, determined as of the date on which the commitment by the trust to purchase the loan becomes binding on the trust. However, in the case of a construction loan or other loan made for purposes of improving or developing real property, the loan value of the real property is the fair market value of the land plus the reasonably estimated cost of the improvements or developments (other than personal property) which will secure the loan and which are to be constructed from the proceeds of the loan. The fair market value of the land and the reasonably estimated cost of improvements or developments shall be determined as of the date on which a commitment to make the loan becomes binding on the trust. If the trust does not make the construction loan but commits itself to provide long-term financing following completion of construction, the loan value of the real property is determined by using the principles for determining the loan value for a construction loan. Moreover, if the mortgage on the real property is given as additional security (or as a substitute for other security) for the loan after the trust's commitment is binding, the real property loan value is its fair market value when it becomes security for the loan (or, if earlier, when the borrower makes a binding commitment to add or substitute the property as security).

(3) *Amount of loan.* For purposes of this paragraph, the amount of the loan means the highest principal amount of the loan outstanding during the taxable year.

(d) *Exception.* Section 856(f)(2) provides an exception to the general rule that amounts received, directly or indirectly, with respect to an obligation do not qualify as "interest" where the determination of the amounts depends in whole or in part on the income or profits of any person. The exception applies where the trust receives or accrues,

with respect to the obligation of its debtor, an amount that is based in whole or in part on a fixed percentage or percentages of receipts or sales of the debtor, and the amount would not qualify as interest solely because the debtor has receipts or sale proceeds that are based on the income or profits of any person. Under this exception only a proportionate part of the amount received or accrued by the trust fails to qualify as interest for purposes of the percentage-of-income requirements of section 856(c) (2) and (3). The proportionate part of the amount received or accrued by the trust that is non-qualified is the lesser of the following two amounts:

(1) The amount received or accrued by the trust from the debtor with respect to the obligation that is based on a fixed percentage or percentages of receipts or sales, or

(2) The product determined by multiplying by a fraction the total amount received or accrued by the trust from the debtor with respect to the obligation. The numerator of the fraction is the amount of receipts or sales of the debtor that is based, in whole or in part, on the income or profits of any person and the denominator is the total amount of the receipts or sales of the debtor. For purposes of the preceding sentence, the only receipts or sales to be taken into account are those taken into account in determining the payment to the trust pursuant to the loan agreement.

(Sec. 856(d)(4) (90 Stat. 1750; 26 U.S.C. 856(d)(4)); sec. 856(e)(5) (88 Stat. 2113; 26 U.S.C. 856(e)(5)); sec. 856(f)(2) (90 Stat. 1751; 26 U.S.C. (856(f)(2)); sec. 856(g)(2) (90 Stat. 1753; 26 U.S.C. 856(g)(2)); sec. 858(a) (74 Stat. 1008; 26 U.S.C. 858(a)); sec. 859(c) (90 Stat. 1743; 26 U.S.C. 859(c)); sec. 859(e) (90 Stat. 1744; 26 U.S.C. 859(e)); sec. 6001 (68A Stat. 731; 26 U.S.C. 6001); sec. 6011 (68A Stat. 732; 26 U.S.C. 6011); sec. 6071 (68A Stat. 749; 26 U.S.C. 6071); sec. 6091 (68A Stat. 752; 26 U.S.C. 6091); sec. 7805 (68A Stat. 917; 26 U.S.C. 7805), Internal Revenue Code of 1954)

[T.D. 7767, 46 FR 11268, Feb. 6, 1981]

#### § 1.856-6 Foreclosure property.

(a) *In general.* Under section 856(e) a real estate investment trust may make an irrevocable election to treat as “foreclosure property” certain real property (including interests in real

property), and any personal property incident to the real property, acquired by the trust after December 31, 1973. This section prescribes rules relating to the election, including rules relating to property eligible for the election. This section also prescribes rules relating to extensions of the general two-year period (hereinafter the “grace period”) during which property retains its status as foreclosure property, as well as rules relating to early termination of the grace period under section 856(e)(4). The election to treat property as foreclosure property does not alter the character of the income derived therefrom (other than for purposes of section 856(c)(2)(F) and (3)(F)). For example, if foreclosure property is sold, the determination of whether it is property described in section 1221(1) will not be affected by the fact that it is foreclosure property.

(b) *Property eligible for the election—(1) Rules relating to acquisitions.* In general, the trust must acquire the property after December 31, 1973, as the result of having bid in the property at foreclosure, or having otherwise reduced the property to ownership or possession by agreement or process of law, after there was default (or default was imminent) on a lease of the property (where the trust was the lessor) or on an indebtedness owed to the trust which the property secured. Foreclosure property which secured an indebtedness owed to the trust is acquired for purposes of section 856(e) on the date on which the trust acquires ownership of the property for Federal income tax purposes. Foreclosure property which a trust owned and leased to another is acquired for purposes of section 856(e) on the date on which the trust acquires possession of the property from its lessee. A trust will not be considered to have acquired ownership of property for purposes of section 856(e) where it takes control of the property as a mortgagee-in-possession and cannot receive any profit or sustain any loss with respect to the property except as a creditor of the mortgagor. A trust may be considered to have acquired ownership of property for purposes of section 856(e) even through legal title to the property is held by another person. For example,