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 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 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).

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

§ 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), it is treated as a dividend under section 301.

(c) *Effective date.* This section applies to distributions announced (within the meaning of section 1059(d)(5)) on or after June 17, 1996.

[T.D. 8724, 62 FR 38028, July 16, 1997]

§ 1.1059A–1 Limitation on taxpayer's basis or inventory cost in property imported from related persons.

(a) *General rule.* In the case of property imported into the United States in a transaction (directly or indirectly) by a controlled taxpayer from another member of a controlled group of taxpayers, except for the adjustments permitted by paragraph (c) (2) of this section, the amount of any costs taken into account in computing the basis or inventory cost of the property by the purchasing U.S. taxpayer and which costs are also taken into account in computing the valuation of the property for customs purposes may not, for purposes of the basis or inventory cost, be greater than the amount of the costs used in computing the customs value. For purposes of this section, the terms *controlled taxpayer* and *group of controlled taxpayers* shall have the meaning set forth in § 1.482–1(a).

(b) *Definitions*—(1) *Import.* For purposes of section 1059A and this section only, the term *import* means the filing of the entry documentation required by the U.S. Customs Service to secure the release of imported merchandise from custody of the U.S. Customs Service.

(2) *Indirectly.* For purposes of this section, *indirectly* refers to a transaction between a controlled taxpayer and another member of the controlled group whereby property is imported through a person acting as an agent of, or otherwise on behalf of, either or both related persons, or as a middleman or conduit for transfer of the property between a controlled taxpayer and another member of the controlled group. In the case of the importation of property indirectly, an adjustment shall be permitted under paragraph (c)(2) of this section for a commission or markup paid to the person acting as agent, middleman, or conduit, only to the extent that the commission or markup: is otherwise properly included in cost basis or inventory cost; was actually incurred by the taxpayer and not remitted, directly or indirectly, to the taxpayer or related party; and there is a substantial business reason for the use of a middleman, agent, or conduit.

(c) *Customs value*—(1) *Definition.* For purposes of this section only, the term *customs value* means the value required to be taken into account for purposes of determining the amount of any customs duties or any other duties which may be imposed on the importation of any property. Where an item or a portion of an item is not subject to any customs duty or is subject to a free rate of duty, such item or portion of such item shall not be subject to the provisions of section 1059A or this section. Thus, for example, the portion of an item that is an American good returned and not subject to duty (items 806.20 and 806.30, Tariff Schedules of the United States, 19 U.S.C. 1202); imports on which no duty is imposed that are valued by customs for statistical purposes only; and items subject to a zero rate of duty (19 U.S.C. 1202, General Headnote 3) are not subject to section 1059A or this section. Also, items subject only to the user fee under 19 U.S.C. 58(c), or the harbor maintenance tax imposed by 26 U.S.C. 4461, or only to both, are not subject to section 1059A or this section. This section imposes no