§ 1.857–6  Method of taxation of share-
holdes of real estate investment trusts.

(a) Ordinary income. Except as other-
wise provided in paragraph (b) of this
section (relating to capital gains), a
shareholder receiving dividends from a
real estate investment trust shall in-
clude such dividends in gross income
for the taxable year in which they are
received. See section 858(b) and para-
graph (c) of § 1.858–1 for treatment by
shareholders of dividends paid by a real
estate investment trust after the close
of its taxable year in the case of an
estate investment trust after the close
of its taxable year in the case of an

(b) Capital gains. Under section
857(b)(3)(B), shareholders of a real es-
teatment trust who receive cap-
tal gain dividends (as defined in para-
graph (e) of this section), in respect of
the capital gains of a corporation,
trust, or association for a taxable year
for which it is taxable under part II of
subchapter M as a real estate invest-
ment trust, shall treat such capital
gain dividends as gains from the sale or
change of a capital asset held for
more than 1 year (6 months for taxable
years beginning before 1977; 9 months
for taxable years beginning in 1977) the
amount of a capital gains dividend,
then such person shall, to the extent of
such amount, treat any loss on the sale
or exchange of such share as a loss
from the sale or exchange of a capital
asset held for more than 1 year (6 months for taxable years beginning be-
fore 1977; 9 months for taxable years
beginning in 1977) the

(c) Special treatment of loss on the sale
or exchange of real estate investment trust
stock held less than 31 days—(1) In gen-
eral. Under section 857(b)(7), if any per-
son with respect to a share of real es-
teatment trust stock stock held for a
period of less than 31 days, is required
by section 857(b)(3)(B) to include in
gross income as a gain from the sale or
change of a capital asset held for
more than 1 year (6 months for taxable
years beginning before 1977; 9 months
for taxable years beginning in 1977) the
amount of a capital gains dividend,
then such person shall, to the extent of
such amount, treat any loss on the sale
or exchange of such share as a loss
from the sale or exchange of a capital
asset held for more than 1 year (6 months for taxable years beginning be-
fore 1977; 9 months for taxable years
beginning in 1977). The rules contained in section 246(c)(3)
relating to the determination of hold-
ing periods for purposes of the deduc-
tion for dividends received) shall be ap-
plicable in determining whether, for pur-
poses of section 857(b)(7)(B) and this
paragraph, a share of real estate inves-
tment trust stock has been held for
a period of less than 31 days. In apply-
ing those rules, however, “30 days”
shall be substituted for the number of
days specified in subparagraph (B) of
such section.

(2) Determination of holding period.
The rules contained in section 246(c)(3)
relating to the determination of hold-
ing periods for purposes of the deduc-
tion for dividends received) shall be ap-
plicable in determining whether, for pur-
poses of section 857(b)(7)(B) and this
paragraph, a share of real estate inves-
tment trust stock has been held for
a period of less than 31 days. In apply-
ing those rules, however, “30 days”
shall be substituted for the number of
days specified in subparagraph (B) of
such section.

(3) Illustration. The application of sec-
tion 857(b)(7) and this paragraph may
be illustrated by the following exam-
ple:

Example. On December 15, 1961, A purchased a share of stock in the S Real Estate Invest-
ment Trust for $20. The S trust declared a
capital gains dividend of $2 to each record holder on December 31, 1961.
A, therefore, received a capital gain dividend of $2 which, pursuant to section 857(b)(3)(B),
he must treat as a gain from the sale or ex-
change of a capital asset held for more than
six months. On January 5, 1962, A sold his
share of stock in the S trust for $17.50, which
sale resulted in a loss of $2.50. Under section
857(b)(4) and this paragraph, A must treat $2
of such loss (an amount equal to the capital
gain dividend received with respect to such
share of stock) as a loss from the sale or ex-
change of a capital asset held for more than
six months.
(d) Dividend received credit, exclusion, and deduction not allowed. Any dividend received from a real estate investment trust which, for the taxable year to which the dividend relates, is a qualified real estate investment trust, shall not be eligible for the dividend received credit (for dividends received on or before December 31, 1964) under section 34(a), the dividend received exclusion under section 116, or the dividend received deduction under section 243.

(e) Definition of capital gain dividend. (1) (i) A capital gain dividend, as defined in section 857(b)(3)(C), is any dividend or part thereof which is designated by a real estate investment trust as a capital gain dividend in a written notice mailed to its shareholders within the period specified in section 857(b)(3)(C) and paragraph (f) of this section. If the aggregate amount so designated with respect to the taxable year (including capital gain dividends paid after the close of the taxable year pursuant to an election under section 858), the real estate investment trust must include in its written notice designating the capital gain dividend a statement showing the shareholder’s proportionate share of such dividend which is gain described in section 1201(d)(1) and his proportionate share of such dividend which is gain described in section 1201(d)(2). In determining the portion of the capital gain dividend which is gain described in section 1201(d)(1) or (2), the real estate investment trust shall consider that capital gain dividends for a taxable year are first made from its long-term capital gains which are not described in section 1201(d)(1) or (2), to the extent thereof, and then from its long-term capital gains for such year which are described in section 1201(d)(1) or (2). A shareholder’s proportionate share of gains which are described in section 1201(d)(1) is the amount which bears the same ratio to the amount paid to him as a capital gain dividend in respect of such year as (i) the aggregate amount of the trust’s gains which are described in section 1201(d)(1) and paid to all shareholders bears to (ii) the aggregate amount of the capital gain dividend paid to all shareholders in respect of such year. A shareholder’s proportionate share of gains which are described in section 1201(d)(2) shall be determined in a similar manner. Every real estate investment trust shall keep a record of the proportion of each capital gain dividend (to which this subparagraph applies) which is gain described in section 1201(d)(1) or (2).

(ii) For purposes of section 857(b)(3)(C) and this paragraph, the net capital gain for a taxable year ending after October 4, 1976, is deemed not to exceed the real estate investment trust taxable income determined by taking into account the net operating loss deduction for the taxable year but not the deduction for dividends paid. See example 2 in §1.172-5(a)(4).

(2) In the case of capital gain dividends designated with respect to any taxable year of a real estate investment trust ending after December 31, 1969, and beginning before January 1, 1975 (including capital gain dividends paid after the close of the taxable year pursuant to an election under section 858), the real estate investment trust must include in its written notice designating the capital gain dividend a statement showing the shareholder’s proportionate share of such dividend which is gain described in section 1201(d)(1) and his proportionate share of such dividend which is gain described in section 1201(d)(2). In determining the portion of the capital gain dividend which is gain described in section 1201(d)(1) or (2), the real estate investment trust shall consider that capital gain dividends for a taxable year are first made from its long-term capital gains which are not described in section 1201(d)(1) or (2), to the extent thereof, and then from its long-term capital gains for such year which are described in section 1201(d)(1) or (2). A shareholder’s proportionate share of gains which are described in section 1201(d)(1) is the amount which bears the same ratio to the amount paid to him as a capital gain dividend in respect of such year as (i) the aggregate amount of the trust’s gains which are described in section 1201(d)(1) and paid to all shareholders bears to (ii) the aggregate amount of the capital gain dividend paid to all shareholders in respect of such year. A shareholder’s proportionate share of gains which are described in section 1201(d)(2) shall be determined in a similar manner. Every real estate investment trust shall keep a record of the proportion of each capital gain dividend (to which this subparagraph applies) which is gain described in section 1201(d)(1) or (2).

(f) Mailing of written notice to shareholders—(1) General rule. Except as provided in paragraph (f)(2) of this section, the written notice designating a dividend or part thereof as a capital gain dividend must be mailed to the shareholders not later than 30 days after the
§ 1.857–7 Earnings and profits of a real estate investment trust.

(a) Any real estate investment trust whether or not such trust meets the requirements of section 857(a) and paragraph (a) of §1.857–1 for any taxable year beginning after December 31, 1960 shall apply paragraph (b) of this section in computing its earnings and profits for such taxable year.

(b) In the determination of the earnings and profits of a real estate investment trust, section 857(d) provides that such earnings and profits for any taxable year (but not the accumulated earnings and profits) shall not be reduced by any amount which is not allowable as a deduction in computing its taxable income for the taxable year. Thus, if a trust would have had earnings and profits of $500,000 for the taxable year except for the fact that it had a net capital loss of $100,000, which amount was not deductible in determining its taxable income, its earnings and profits for that year if it is a real estate investment trust would be $500,000. If the real estate investment trust had no accumulated earnings and profits at the beginning of the taxable year, in determining its accumulated earnings and profits as of the beginning of the following taxable year, the earnings and profits for the taxable year to be considered in such computation would amount to $400,000 assuming