§ 1.857–6  

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§ 1.857–6  Method of taxation of shareholders of real estate investment trusts.

(a) Ordinary income. Except as otherwise provided in paragraph (b) of this section (relating to capital gains), a shareholder receiving dividends from a real estate investment trust shall include such dividends in gross income for the taxable year in which they are received. See section 858(b) and paragraph (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 election under section 858(a).

(b) Capital gains. Under section 857(b)(3)(B), shareholders of a real estate investment trust who receive capital gain dividends (as defined in paragraph (e) of this section) in respect of any taxable year of a real estate investment trust, shall treat such capital gain dividends as gains from the sale or exchange of capital assets held for more than one year (6 months for taxable years beginning before 1977; 9 months for taxable years beginning in 1977) and realized in the taxable year of the shareholder in which the dividend was received. In the case of dividends with respect to any taxable year of a real estate investment trust ending after December 31, 1969, and beginning before January 1, 1975, the portion of a shareholder’s capital gain dividend which in his hands is gain to which section 1221(d)(1) or (2) applies is the portion so designated by the real estate investment trust pursuant to paragraph (e)(2) of this section.

(c) Special treatment of loss on the sale or exchange of real estate investment trust stock held less than 31 days—(1) In general. Under section 857(b)(7), if any person with respect to a share of real estate investment trust 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 exchange 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 before 1977; 9 months for taxable years beginning in 1977).

(2) Determination of holding period. The rules contained in section 246(c)(3), relating to the determination of holding periods for purposes of the deduction for dividends received shall be applied in determining whether, for purposes of section 857(b)(7)(B) and this paragraph, a share of real estate investment trust stock has been held for a period of less than 31 days. In applying 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 section 857(b)(7) and this paragraph may be illustrated by the following example:

Example. On December 15, 1961, A purchased a share of stock in the S Real Estate Investment Trust for $20. The S trust declared a capital gains dividend of $2 per share to shareholders of record 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 exchange 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 exchange 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) is greater than the net capital gain of the taxable year, the portion of each distribution which shall be a capital gain dividend shall be only that proportion of the amount so designated which such excess of the net long-term capital gain over the net short-term capital loss bears to the aggregate of the amount so designated.

For example, a real estate investment trust making its return on the calendar year basis advised its shareholders by written notice mailed December 30, 1961, that $200,000 of a distribution of $500,000 made December 15, 1961, constituted a capital gain dividend, amounting to $2 per share. It was later discovered that an error had been made in determining the net capital gain of the taxable year and that the net capital gain was $100,000 instead of $200,000. In such case, each shareholder would have received a capital gain dividend of $1 per share instead of $2 per share.

(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, in the hands of a shareholder, 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.

(3) 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 close of the taxable year of the real estate investment trust.
§ 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 that there had been no distribution from such earnings and profits. If distributions had been made in the taxable year in the amount of the earnings and profits then available for distribution, $500,000, the trust would have as of the beginning of the following taxable year neither accumulated earnings and profits nor a deficit in accumulated earnings and profits, and would begin such year with its paid-in capital reduced by $100,000, an amount equal to the excess of the $500,000 distributed over the $400,000 accumulated