

REAL ESTATE INVESTMENT TRUSTS

JULY 25 (legislative day, JULY 16), 1956.—Ordered to be printed

Mr. BYRD, from the Committee on Finance, submitted the following

REPORT

[To accompany H. R. 4392]

The Committee on Finance, to whom was referred the bill (H. R. 4392) to amend the Internal Revenue Code of 1954 to provide a special method of taxation for real estate investment trusts, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

By virtue of this act, the Committee on Finance accepts the report of the Committee on Ways and Means, which is as follows:

I. GENERAL STATEMENT

H. R. 4392 as amended by your committee provides substantially the same tax treatment for real estate investment trusts as present law provides for regulated investment companies. Real estate trusts are organizations specializing in investments in real estate and real estate mortgages, while the regulated investment companies specialize in investments in stocks and securities. Under present law regulated investment companies which distribute 90 percent or more of their ordinary income are taxed only on their retained earnings. In general, the beneficiaries of these companies are treated as if they had received the income directly from the same sources as the investment company. This conduit type of tax treatment is accorded by this bill to real estate trusts. Your committee has amended this bill to restrict this tax treatment to what are clearly passive real estate investments, as contrasted to the active operation of businesses involving real estate.

II. REASONS FOR THE BILL

In the case of regulated investment companies, individuals desiring to invest in stocks and securities pool their funds by buying shares in investment companies, which in turn invest these resources in stocks and securities of operating companies.

These companies investing in stock and securities are known as regulated investment companies if they meet various requirements with respect to asset diversification, capital structure, and operations. Such companies if they distribute at least 90 percent of their ordinary income are treated as conduits of income and are taxed only on their undistributed income. Dividends paid by such companies generally are taxed in the usual manner to shareholders, except that dividends arising from capital gains realized by the company receive capital gains treatment in the hands of the recipient and dividends, which to an important degree are attributable to interest or other non-dividend income, are, to the extent of that portion, not eligible for the dividends received credit, exclusion, or deduction.

This conduit type of tax treatment, which present law provides for regulated investment companies, secures for investors in these companies essentially the same tax treatment for their shareholders as they would have received if they had invested directly in the operating companies. H. R. 4392 as reported by your committee extends this conduit type of tax treatment to real estate trusts specializing in investments in real estate equities and mortgages as distinct from the stock and security holdings of the regulated investment companies already receiving this treatment. Thus this secures for the trust beneficiaries the same type of tax treatment they would receive if they held the real estate equities and mortgages directly and, therefore, equates their treatment with that accorded investors in regulated investment companies.

Your committee believes that the equality of tax treatment between the beneficiaries of real estate trusts and the shareholders of regulated investment companies is desirable since in both cases the methods of investment constitute pooling arrangements whereby small investors can secure advantages normally available only to those with larger resources. These advantages include the spreading of the risk of loss by the greater diversification of investment which can be secured through the pooling arrangements; the opportunity to secure the benefits of expert investment counsel; and the means of collectively financing projects which the investors could not undertake singly.

In addition to providing equality of tax treatment between the trust beneficiaries and the investment company shareholders, your committee believes it is also desirable to remove taxation to the extent possible as a factor in determining the relative size of investments in stocks and securities, on one hand, and real estate equities and mortgages, on the other. This is particularly important at the present time because of the countrywide complaints about the shortage of private capital and mortgage money for individual homes, apartment houses, office buildings, factories, and hotels. At the present time the financing of these real estate equities and mortgages is dependent largely on Government-guaranteed money, and investments by special groups, such as insurance companies and pension trusts.

As is pointed out in the next part of this report, H. R. 4392, as amended by your committee, to the full extent feasible, makes the requirements and conditions now applicable to regulated investment trusts, applicable to the real estate investment trusts. In the reported bill your committee has also taken care to draw a sharp line between passive investments and the active operation of businesses, and has

extended the conduit type of tax treatment only to the passive investments of real estate trusts. Your committee believes that any real estate trust engaging in active business operations should continue to be subject to the corporate tax in the same manner as is true in the case of similar operations carried on by other comparable enterprises.

III. SUMMARY OF PROVISIONS OF BILL

A. Definition of Real Estate Investment Trust

1. *General requirements.*—In general terms, real estate investment trusts are defined as unincorporated trusts or associations meeting certain general requirements and, in addition, meeting a series of requirements as to amounts of various types of gross income. The general requirements include provisions that they be managed by trustees, have transferable shares or certificates of beneficial interest, and that they be a type of organization which would be taxed as an ordinary domestic corporation in the absence of the provisions of this bill. These are no more than the commonly accepted characteristics of real estate trusts.

The bill also provides that qualifying real estate trusts meet the following requirements.

(a) The beneficial ownership must at all times during the taxable year be held by 100 or more persons;

(b) No 5 individuals may, at any time during the taxable year, directly or indirectly own more than 50 percent of the trust;

(c) The trust must elect to be treated as a real estate investment trust for the taxable and subsequent years; and

(d) The trust may not during the taxable year hold any property primarily for sale to customers in the ordinary course of its trade or business.

The first three of the above requirements are similar to conditions which must be met by regulated investment companies. The 100-or-more ownership test, is substantially the equivalent of a requirement which regulated investment companies must meet in complying with the Investment Company Act of 1940. The 50-percent test which must be complied with in the case of 5 or fewer individuals is derived from the definition of a personal holding company, which may not under present law qualify as a regulated investment company. In the determination of whether these 5 or fewer individuals own directly or indirectly more than 50 percent of the beneficial ownership of a trust, the term "directly or indirectly" is intended to have the same meaning as when that term is used in connection with personal holding companies. The provision as to the election also is substantially the same as a provision applying at present to regulated investment companies.

The fourth requirement, that the trust not be holding property primarily for sale to customers in the ordinary course of its trade or business, is one of the provisions in the bill designed to make sure that the trust does not engage in an active business enterprise. Another provision of this type is discussed further below.

2. *Income requirements.*—The income requirements, all of which must be met by a qualifying real estate trust, are divided into four categories. The first of these tests provides that 90 percent or more of a trust's gross income must be of the type provided if it is to qualify. The types of income which qualify for the 90 percent test are dividends,

interest, rents from real property, gains from the sale of stocks, securities, and real property, and abatement and refunds of taxes on real property. This provision is substantially the same as the present 90 percent test provided for regulated investment companies, except for the addition of the various types of income derived from real property.

The second income test provided for real estate trusts is entirely new; there is no corresponding provision for the regulated investment companies. Under this test at least 60 percent of the trust's income must, in one manner or another, be derived from real property. The types of income within the 60 percent category include rents from real property, interest on obligations secured by mortgages on real estate, gain from the sale of real property, dividend and other distributions from other real estate trusts qualifying under this bill, and abatement and refunds of taxes on real property.

The interaction of the 90 and 60 percent tests requires at least 60 percent of the trust's income to be derived from real property; another 30 percent must be derived either from real property or from sources from which a regulated investment company would be required to derive most of its income.

The third and fourth income requirements are concerned with gains from the sale of property. The third test provides that not more than 30 percent of the trust gross income may consist of short-term gains on security sales. This provision is similar, although not identical, to a provision in present law applying to regulated investment companies. The 30 percent in the case of the trust applies to sales of securities held for less than 6 months, while that for regulated investment companies applies to sales of securities held for less than 3 months. In addition, the percentage in the case of the trusts is applied only with respect to the extent the gains exceed the losses. The 30 percent test in the case of the regulated investment companies applies without the reduction for losses.

The fourth test applies a 30 percent limitation on the amount of gross income which may be derived from gains on the sale of real estate held for less than 5 years. In this case also the 30 percent test is applied only to the gains in excess of losses. This, in conjunction with the general requirement that the trust must not hold any property primarily for sale to customers in the ordinary course of its trade or business, will give assurance of qualifying little if any income from trading in real estate except sales of investment property.

3. *Definition of rents from real property.*—As indicated in the prior part of this report, your committee has made sure that transactions which might be considered active business operations are not given the conduit type of tax treatment accorded under this bill. For example, it is felt that those who own and also manage a hotel or office building are operating an active business enterprise and that the regular corporate income tax rate should continue to apply in such cases. To restrict income to that of a passive nature, the bill defines rents from real property in such a manner as to exclude income from any real property which the trust operates. Qualifying rents from real property do not include any amount received or accrued with respect to any real property, if the trust or association makes any expenditure which is properly allocable to such real property while rented (or to the rentals from such real property). As a result, rents are defined as

excluding amounts received, if the trust makes any expenditure, other than excepted types of expenditures, with respect to the real property while it is rented. This, in general, would disqualify rents received from real estate if the trust makes any expenditure, with respect to that real estate, which would qualify as a trade or business expense under the provisions of section 162 of the code. The expenditures which may be made are those properly chargeable to capital account, those for taxes, interest, or insurance, those for the collection of or accounting for income, and those related to the entering into, renewal, or termination of a lease. This, of course, would not deny other deductions which might be allowed with respect to the property under present law which do not result in expenditures. For example, this would not foreclose a deduction for depreciation. This provision would, however, foreclose a trust from making an expenditure for the maintenance or operation of a building. Such expenditures, in order to make sure that the lessor's position is that of a passive investor with respect to the operation of a building, would have to be incurred by the person to whom the trust leases the property. This lessee could, of course, engage in the active conduct of the trade or business of operating the building.

Rental income is also defined as excluding amounts derived from property if these amounts depend in whole or in part on the income or profits derived by any person from the property. This is provided to give assurance that no profit-sharing arrangement, provided for in the rental contract, will in effect make the trust an active participant in the operation of the property. Income from the operation of a store on a business property would, of course, be income derived from this property.

An exception to the general rule is provided for amounts based on a fixed percentage or percentages of receipts and sales since these are customary types of rental contracts and are not generally considered related to the profit or loss of the lessee. Generally speaking, therefore, rents received from real estate would not be disqualified solely by reason of the fact that the rent is based on a fixed percentage of total receipts or sales of the lessee (whether or not adjusted for such items as returned merchandise, or Federal, State, or local sales taxes). It is not intended to disqualify situations where the lease provides for differing percentages of receipts or sales from different departments or from separate floors of a retail store, for example, so long as each percentage is fixed at the time of entering into the lease. However, the fact that a lease is based upon a percentage of total receipts would not necessarily qualify the rent as "rent from real property." Thus, for example, rent would not qualify if the lease provides for a rental measured by varying percentages of receipts, and the arrangement does not conform with normal business practices where rental percentages are based on receipts, but is in reality used as a means of basing the rent on income or profits.

Still a third restriction provided in the case of rents from real property excludes from the definition of rents amounts received from any person if the trust has an interest of 10 percent or more in the business, assets, or profits of that person. This prevents the avoidance of the restrictions described above with respect to rents from real estate through the device of setting up a related organization. It also forecloses the opportunity of any substantial relationship between the trust and the business of any tenant.

B. Taxation of Real Estate Investment Trusts and Their Beneficiaries

As has been previously indicated, this bill provides the conduit type of tax treatment in the case of real estate investment trusts which distribute 90 percent or more of their ordinary taxable income (that is, exclusive of net long-term and short-term capital gains). Any amount in excess of the 90 percent which the trust retains, however, is to be subject to the regular corporate income tax.

The beneficiaries of the trust in general will continue to be taxed in the same manner as ordinary dividend recipients. Capital gains of the trust, however, to the extent they are distributed are free of tax at the trust level and at the shareholder level are taxed as long-term capital gains rather than as an ordinary dividend.

Where more than 25 percent of the income of the real estate trust is from rents, interest, or other nondividend income the trust beneficiary is to treat as a dividend only that portion of the dividend payment he receives which corresponds to the percentage of the trust's income which was attributable to dividends. Any amount not treated as a dividend to the beneficiary would not be eligible for the dividends received credit, exclusion or deduction, but would be taxed as ordinary income to the recipient. If the interest and other nondividend income is less than 25 percent of the trust's total income, the entire distribution to the beneficiary (exclusive of capital gains dividends) is treated as if it were the receipt of an ordinary dividend and eligible for the dividends received credit and exclusion.

The treatment outlined above for real estate trusts is substantially that now provided in the case of regulated investment companies, although it should be noted that the differences include some variations in the treatment of undistributed capital gains and the foreign tax credit.

CHANGES IN EXISTING LAW

In compliance with subsection 4 of rule XXIX of the Standing Rules of the Senate, changes in existing law made by the bill are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italics, existing law in which no change is proposed is shown in roman):

INTERNAL REVENUE CODE OF 1954**Chapter 1—Normal Taxes and Surtaxes**

- SUBCHAPTER A. Determination of tax liability.
- SUBCHAPTER B. Computation of taxable income.
- SUBCHAPTER C. Corporate distributions and adjustments.
- SUBCHAPTER D. Deferred compensation, etc.
- SUBCHAPTER E. Accounting periods and methods of accounting.
- SUBCHAPTER F. Exempt organizations.
- SUBCHAPTER G. Corporations used to avoid income tax on shareholders.
- SUBCHAPTER H. Banking institutions.
- SUBCHAPTER I. Natural resources.
- SUBCHAPTER J. Estates, trusts, beneficiaries, and decedents.
- SUBCHAPTER K. Partners and partnerships.
- SUBCHAPTER L. Insurance companies.
- SUBCHAPTER M. Regulated investment companies and real estate investment trusts.

- SUBCHAPTER N. Tax based on income from sources within or without the United States.
- SUBCHAPTER O. Gain or loss on disposition of property.
- SUBCHAPTER P. Capital gains and losses.
- SUBCHAPTER Q. Readjustment of tax between years and special limitations.
- SUBCHAPTER R. Election of certain partnerships and proprietorships as to taxable status.

SUBCHAPTER A—DETERMINATION OF TAX LIABILITY

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Part I—Tax on Individuals

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Part II—Tax on Corporations

- Sec. 11. Tax imposed.
- Sec. 12. Cross references relating to tax on corporations.

SEC. 11. TAX IMPOSED

(a) **CORPORATIONS IN GENERAL.**—A tax is hereby imposed for each taxable year on the taxable income of every corporation. The tax shall consist of a normal tax computed under subsection (b) and a surtax computed under subsection (c).

(b) **NORMAL TAX.**—

(1) **TAXABLE YEARS BEGINNING BEFORE APRIL 1, 1957.**—In the case of a taxable year beginning before April 1, 1957, the normal tax is equal to 30 percent of the taxable income.

(2) **TAXABLE YEARS BEGINNING AFTER MARCH 31, 1957.**—In the case of a taxable year beginning after March 31, 1957, the normal tax is equal to 25 percent of the taxable income.

(c) **SURTAX.**—The surtax is equal to 22 percent of the amount by which the taxable income (computed without regard to the deduction, if any, provided in section 242 for partially tax-exempt interest) exceeds \$25,000.

(d) **EXCEPTIONS.**—Subsection (a) shall not apply to a corporation subject to a tax imposed by—

(1) section 594 (relating to mutual savings banks conducting life insurance business),

(2) subchapter L (sec. 801 and following, relating to insurance companies),

(3) subchapter M (sec. 851 and following, relating to regulated investment companies and real estate investment trusts), or

(4) section 881 (a) (relating to foreign corporations not engaged in business in United States).

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Part IV—Credits Against Tax

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SEC. 34. DIVIDENDS RECEIVED BY INDIVIDUALS.

(a) **GENERAL RULE.**— * * *

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(d) SPECIAL RULES FOR CERTAIN DISTRIBUTIONS.—For purposes of subsection (a)—

(1) Any amount allowed as a deduction under section 591 (relating to deduction for dividends paid by mutual savings banks, etc.) shall not be treated as a dividend.

(2) A dividend received from a regulated investment company shall be subject to the limitations prescribed in section 854.

(3) *A dividend received from a real estate investment trust shall be subject to the limitations prescribed in section 858.*

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SUBCHAPTER B—COMPUTATION OF TAXABLE INCOME

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Part I—Definition of Gross Income, Adjusted Gross Income, and Taxable Income

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Part III—Items Specifically Excluded From Gross Income

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SEC. 116. PARTIAL EXCLUSION OF DIVIDENDS RECEIVED BY INDIVIDUALS.

(a) EXCLUSION FROM GROSS INCOME.— * * *

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(c) SPECIAL RULES FOR CERTAIN DISTRIBUTIONS.—For purposes of subsection (a)—

(1) Any amount allowed as a deduction under section 591 (relating to deduction for dividends paid by mutual savings banks, etc.) shall not be treated as a dividend.

(2) A dividend received from a regulated investment company shall be subject to the limitations prescribed in section 854.

(3) *A dividend received from a real estate investment trust shall be subject to the limitations prescribed in section 858.*

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Part VIII—Special Deductions for Corporations

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SEC. 243. DIVIDENDS RECEIVED BY CORPORATIONS.

(a) GENERAL RULE.—* * *

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(b) SPECIAL RULES FOR CERTAIN DISTRIBUTIONS.—For purposes of subsection (a)—

(1) Any amount allowed as a deduction under section 591 (relating to deduction for dividends paid by mutual savings banks, etc.) shall not be treated as a dividend.

(2) A dividend received from a regulated investment company shall be subject to the limitations prescribed in section 854.

(3) *A dividend received from a real estate investment trust shall be subject to the limitations prescribed in section 858.*

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SUBCHAPTER C—CORPORATE DISTRIBUTIONS AND ADJUSTMENTS

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Part I—Distributions by Corporations

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SEC. 318. CONSTRUCTIVE OWNERSHIP OF STOCK.

- (a) **GENERAL RULE.**—* * *
- (b) **CROSS REFERENCES.**—

For provisions to which the rules contained in subsection (a) apply, see—

- (1) section 302 (relating to redemption of stock);
- (2) section 304 (relating to redemption by related corporations);
- (3) section 306 (b) (1) (A) (relating to disposition of section 306 stock);
- (4) section 334 (b) (3) (C) (relating to basis of property received in certain liquidations of subsidiaries); **[and]**
- (5) section 382 (a) (3) (relating to special limitations on net operating loss carryovers) **[.]**; *and*
- (6) *section 856 (c) (3) (relating to definition of real estate investment trusts).*

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SUBCHAPTER E—ACCOUNTING PERIODS AND METHODS OF ACCOUNTING

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Part I—Accounting Periods

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SEC. 443. RETURNS FOR A PERIOD OF LESS THAN 12 MONTHS.

- (a) **RETURNS FOR SHORT PERIOD.**— * * *

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- (d) **CROSS REFERENCE.**—

For inapplicability of subsection (b) in computing—

- (1) Accumulated earnings tax, see section 536.
- (2) Personal holding company tax, see section 546.
- (3) Undistributed foreign personal holding company income, see section 557.
- (4) The taxable income of a regulated investment company, see section 852 (b) (2) (E).
- (5) *The taxable income of a real estate investment trust, see section 857 (b) (2) (D).*

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[SUBCHAPTER M—REGULATED INVESTMENT COMPANIES]**SUBCHAPTER M—REGULATED INVESTMENT COMPANIES
AND REAL ESTATE INVESTMENT TRUSTS***Part I. Regulated investment companies.**Part II. Real estate investment trusts.***Part I—Regulated Investment Companies**

Sec. 851. Definition of regulated investment company.

Sec. 852. Taxation of regulated investment companies and their shareholders.

Sec. 853. Foreign tax credit allowed to shareholders.

Sec. 854. Limitations applicable to dividends received from regulated investment company.

Sec. 855. Dividends paid by regulated investment company after close of taxable year.

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**SEC. 852. TAXATION OF REGULATED INVESTMENT COMPANIES
AND THEIR SHAREHOLDERS.**

(a) **REQUIREMENTS APPLICABLE TO REGULATED INVESTMENT COMPANIES.**—The provisions of this [subchapter] *part* shall not be applicable to a regulated investment company for a taxable year unless—

(1) the deduction for dividends paid during the taxable year (as defined in section 561, but without regard to capital gains dividends) equals or exceeds 90 percent of its investment company taxable income for the taxable year (determined without regard to subsection (b) (2) (D)), and

(2) the investment company complies for such year with regulations prescribed by the Secretary or his delegate for the purpose of ascertaining the actual ownership of its outstanding stock.

(b) **METHOD OF TAXATION OF COMPANIES AND SHAREHOLDERS.**—

(1) **IMPOSITION OF NORMAL TAX AND SURTAX ON REGULATED INVESTMENT COMPANIES.**—There is hereby imposed for each taxable year upon the investment company taxable income of every regulated investment company a normal tax and surtax computed as provided in section 11, as though the investment company taxable income were the taxable income referred to in section 11. For purposes of computing the normal tax under section 11, the taxable income and the dividends paid deduction of such investment company for the taxable year (computed without regard to capital gains dividends) shall be reduced by the deduction provided by section 242 (relating to partially tax-exempt interest).

(2) **INVESTMENT COMPANY TAXABLE INCOME.**—The investment company taxable income shall be the taxable income of the regulated investment company adjusted as follows:

(A) There shall be excluded the excess, if any, of the net long-term capital gain over the net short-term capital loss.

(B) The net operating loss deduction provided in section 172 shall not be allowed.

(C) The deductions for corporations provided in part VIII (except section 248) in subchapter B (section 241 and

following, relating to the deduction for dividends received, etc.), shall not be allowed.

(D) The deduction for dividends paid (as defined in section 561) shall be allowed, but shall be computed without regard to capital gains dividends.

(E) The taxable income shall be computed without regard to section 443 (b) (relating to computation of tax on change of annual accounting period).

(3) CAPITAL GAINS.—

(A) IMPOSITION OF TAX.—There is hereby imposed for each taxable year in the case of every regulated investment company a tax of 25 percent of the excess, if any, of the next long-term capital gain over the sum of—

(i) the net short-term capital loss, and

(ii) the deduction for dividends paid (as defined in section 561) determined with reference to capital gains dividends only.

(B) TREATMENT OF CAPITAL GAIN DIVIDENDS BY SHAREHOLDERS.—A capital gain dividend shall be treated by the shareholders as a gain from the sale or exchange of a capital asset held for more than 6 months.

(C) DEFINITION OF CAPITAL GAIN DIVIDEND.—[A capital gain dividend means] *For purposes of this part, a capital gain dividend is any dividend, or part thereof, which is designated by the company as a capital gain dividend in a written notice mailed to its shareholders not later than 30 days after the close of its taxable year. If the aggregate amount so designated with respect to a taxable year of the company (including capital gains dividends paid after the close of the taxable year described in section 855) is greater than the excess of the net long-term capital gain over the net short-term capital loss 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 amount so designated.*

(D) TREATMENT BY SHAREHOLDERS OF UNDISTRIBUTED CAPITAL GAINS.—

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Part II--Real Estate Investment Trusts

Sec. 856. Definition of real estate investment trust.

Sec. 857. Taxation of real estate investment trusts and their beneficiaries.

Sec. 858. Limitations applicable to dividends received from real estate investment trust.

Sec. 859. Dividends paid by real estate investment trust after close of taxable year.

SEC. 856. DEFINITION OF REAL ESTATE INVESTMENT TRUST.

(a) *IN GENERAL.*—*For purposes of this subtitle, the term "real estate investment trust" means an unincorporated trust or an unincorporated association—*

(1) *which is managed by one or more trustees;*

(2) *the beneficial ownership of which is evidenced by transferable shares, or by transferable certificates of beneficial interest;*

(3) which (but for the provisions of this part) would be taxable as a domestic corporation;

(4) which does not hold any property primarily for sale to customers in the ordinary course of its trade or business;

(5) the beneficial ownership of which is held by 100 or more persons, and no 5 individuals own (directly or indirectly) more than 50 percent of such beneficial ownership; and

(6) which meets the requirements of subsection (b).

(b) **LIMITATIONS.**—A trust or association shall not be considered real estate investment trust for any taxable year unless—

(1) It files with its return for the taxable year an election to be a real estate investment trust or has made such election for a previous taxable year which began after December 31, 1955.

(2) At least 90 percent of its gross income is derived from—

(A) dividends;

(B) interest;

(C) rents from real property;

(D) gain from the sale or other disposition of stock, securities, and real property (including interests in real property and interests in mortgages on real property); and

(E) abatements and refunds of taxes on real property.

(3) At least 60 percent of its gross income is derived from—

(A) rents from real property;

(B) interest on obligations secured by mortgages and on real estate;

(C) gain from the sale or other disposition of real property (including interests in real property and interests in mortgages on real property);

(D) dividend or other distributions on, and gain from the sale or other disposition of, transferable shares in (or transferable certificates of beneficial interest in) other real estate trusts or associations; and

(E) abatements and refunds of taxes on real property.

(4) The amount by which the gains from the sales and other dispositions of stock or securities held for less than 6 months exceed the losses from such sales or other dispositions is an amount less than 30 percent of its gross income.

(5) The amount by which the gains from voluntary sales and other voluntary dispositions of real property held for less than 5 years exceed the losses from such sales and dispositions is an amount less than 30 percent of its gross income.

(c) **RENTS FROM REAL PROPERTY DEFINED.**—For purposes of paragraphs (2) and (3) of subsection (b), the term "rents from real property" does not include—

(1) any amount received or accrued with respect to any real property, if the trust or association makes any expenditure which is properly allocable to such real property while rented (or to the rentals from such real property), other than—

(A) expenditures properly chargeable to capital account;

(B) expenditures for taxes, interest, or insurance;

(C) expenditures for the collection of, or the accounting for, income; and

(D) expenditures properly allocable to the entering into, renewal, or termination of any lease;

(2) any amount received or accrued with respect to any real property, if the amount to be derived from such property depends in whole or in part on the income or profits derived by any person from such property (except that any amount so received or accrued shall not be excluded from the term "rents from real property" solely by reason of being based on a fixed percentage or percentages of receipts or sales); or

(3) any amount received or accrued directly or indirectly from any person if the trust or association owns, directly or indirectly—

(A) in the case of any person which is a corporation, stock of such person possessing 10 percent or more of the total combined voting power of all classes of stock entitled to vote, or 10 percent or more of the total number of shares of all classes of stock of such person; or

(B) in the case of any person which is not a corporation, an interest of 10 percent or more in the business, assets, or net profits of such person.

For purposes of paragraph (3) of this subsection, the rules prescribed by section 318 (a) for determining the ownership of stock shall apply in determining the ownership of stock, business, assets, or net profits of any person. For purposes of the preceding sentence, section 318 (a) (2) (C) shall be applied without regard to the 50 percent limitation contained therein.

SEC. 857. TAXATION OF REAL ESTATE INVESTMENT TRUSTS AND THEIR BENEFICIARIES.

(c) **REQUIREMENTS APPLICABLE TO REAL ESTATE INVESTMENT TRUSTS.**—The provisions of this part shall not apply to a real estate investment trust for a taxable year unless—

(1) it distributes to its shareholders or holders of beneficial interests an amount not less than 90 percent of the amount by which the real estate investment trust taxable income for the taxable year exceeds the sum of its net long-term capital gain and net short-term capital gain for such year; and

(2) the real estate investment trust complies for such year with regulations prescribed by the Secretary or his delegate for the purpose of ascertaining the actual ownership of the shares or certificates of beneficial interest of such trust.

(b) **METHOD OF TAXATION OF REAL ESTATE INVESTMENT TRUSTS AND HOLDERS OF SHARES OR CERTIFICATES OF BENEFICIAL INTEREST.**—

(1) **IMPOSITION OF NORMAL TAX AND SURTAX ON REAL ESTATE INVESTMENT TRUSTS.**—There is hereby imposed for each taxable year on the real estate investment trust taxable income of every real estate investment trust a normal tax and surtax computed as provided in section 11, as though the real estate investment trust taxable income were the taxable income referred to in section 11. For purposes of computing the normal tax under section 11, the taxable income and the dividends paid deduction of such real estate investment trust for the taxable year (computed without regard to capital gain dividends) shall be reduced by the deduction provided by section 242 (relating to partially tax-exempt interest).

(2) **REAL ESTATE INVESTMENT TRUST TAXABLE INCOME.**—For purposes of this part, the term "real estate investment trust taxable

income" means the taxable income of the real estate investment trust, adjusted as follows:

(A) There shall be excluded the excess, if any, of the net long-term capital gain over the net short-term capital loss.

(B) The deductions for corporations provided in part VIII (except section 248) in subchapter B (section 241 and following, relating to the deduction for dividends received, etc.) shall not be allowed.

(C) A deduction shall be allowed for the dividends (other than capital gain dividends) paid during the taxable year computed in accordance with the rules provided in section 562.

(D) The taxable income shall be computed without regard to section 443 (b) (relating to computation of tax on change of annual accounting period).

(E) The net operating loss deduction provided in section 172 shall not be allowed.

(3) CAPITAL GAINS.—

(A) IMPOSITION OF TAX.—There is hereby imposed for each taxable year in the case of every real estate investment trust a tax of 25 percent of the excess, if any, of the net long-term capital gain over the sum of—

(i) the net short-term capital loss; and

(ii) the amount of capital gain dividends paid during the taxable year.

For the purposes of this subparagraph the amount of dividends paid shall be computed under the rules provided in section 562.

(B) TREATMENT OF CAPITAL GAIN DIVIDENDS BY SHAREHOLDERS.—A capital gain dividend shall be treated by the shareholders or holders of beneficial interests as a gain from the sale or exchange of a capital asset held for more than 6 months.

(C) DEFINITION OF CAPITAL GAIN DIVIDEND.—For purposes of this part, a capital gain dividend is any dividend, or part thereof, which is designated by the real estate investment trust as a capital gain dividend in a written notice mailed to its shareholders or holders of beneficial interests at any time before the expiration of 30 days after the close of its taxable year. If the aggregate amount so designated with respect to a taxable year of the trust (including capital gain dividends paid after the close of the taxable year described in section 859) is greater than the excess of the net long-term capital gain over the net short-term capital loss 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 amount so designated.

(c) EARNINGS AND PROFITS.—The earnings and profits of a real estate investment trust for any taxable year (but not its accumulated earnings and profits) shall not be reduced by any amount which is not allowable as a deduction in computing its taxable income for such taxable year.

SEC. 858. LIMITATIONS APPLICABLE TO DIVIDENDS RECEIVED FROM REAL ESTATE INVESTMENT TRUST.

(a) CAPITAL GAIN DIVIDEND.—For purposes of section 34 (a) (relating to credit for dividends received by individuals), section 116

(relating to an exclusion for dividends received by individuals), and section 243 (relating to deductions for dividends received by corporations), a capital gain dividend (as defined in section 857 (b) (3) (C)) received from a real estate investment trust shall not be considered as a dividend.

(b) **OTHER DIVIDENDS.**—

(1) **GENERAL RULE.**—In the case of a dividend received from a real estate investment trust (other than a dividend to which subsection (a) applies)—

(A) if such real estate investment trust meets the requirements of sections 856 and 857 (a) for the taxable year during which it paid such dividend; and

(B) the aggregate dividends received by such trust during such taxable year are less than 75 percent of its gross income, then, in computing the credit under section 34 (a), the exclusion under section 116, and the deduction under section 243, there shall be taken into account only that portion of the dividend which bears the same ratio to the amount of such dividend as the aggregate dividends received by such trust during such taxable year bear to its gross income for such taxable year.

(2) **NOTICE TO SHAREHOLDERS.**—A real estate investment trust to which paragraph (1) applies for any taxable year shall, in a written notice to shareholders or holders of beneficial interests mailed not later than 30 days after the close of the taxable year, designate the portion of the dividends paid by the real estate investment trust during such taxable year which may be taken into account under paragraph (1) for purposes of the credit under section 34, the exclusion under section 116, and the deduction under section 243.

(3) **DEFINITIONS.**—For purposes of this subsection—

(A) The term “gross income” does not include gain from the sale or other disposition of stock or securities or of real estate (or interests therein).

(B) The term “aggregate dividends received” includes only dividends received from domestic corporations other than dividends described in section 116 (b) (relating to dividends excluded from gross income). In determining the amount of any dividend for purposes of this subparagraph, the rules provided in section 116 (c) (relating to certain distributions) shall apply.

SEC. 859. DIVIDENDS PAID BY REAL ESTATE INVESTMENT TRUST AFTER CLOSE OF TAXABLE YEAR.

(a) **GENERAL RULE.**—For purposes of this chapter, if a real estate investment trust—

(1) declares a dividend before the time prescribed by law for the filing of its return for a taxable year (including the period of any extension of time granted for filing such return); and

(2) distributes the amount of such dividend to shareholders or holders of beneficial interests in the 12-month period following the close of such taxable year and not later than the date of the first regular dividend payment made after such declaration, the amount so declared and distributed shall, to the extent the trust elects in such return in accordance with regulations prescribed by the Secretary or his delegats, be considered as having been paid during such taxable year, except as provided in subsections (b) and (c).

(b) *RECEIPT BY SHAREHOLDER.*—Amounts to which subsection (a) applies shall be treated as received by the shareholder or holder of a beneficial interest in the taxable year in which the distribution is made.

(c) *NOTICE TO SHAREHOLDERS.*—In the case of amounts to which subsection (a) applies, any notice to shareholders or holders of beneficial interests required under this part with respect to such amounts shall be made not later than 30 days after the close of the taxable year in which the distribution is made.

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Chapter 6 Consolidated Returns

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SUBCHAPTER A—RETURNS AND PAYMENT OF TAX

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SEC. 1504. DEFINITIONS.

(a) DEFINITION OF "AFFILIATED GROUP".—* * *

(b) DEFINITION OF "INCLUDIBLE CORPORATION".—As used in this chapter, the term "includible corporation" means any corporation except—

- (1) Corporations exempt from taxation under section 501.
- (2) Insurance companies subject to taxation under section 802, 811, or 821.
- (3) Foreign corporations.
- (4) Corporations entitled to the benefits of section 931, by reason of receiving a large percentage of their income from sources within possessions of the United States.
- (5) Corporations organized under the China Trade Act, 1922.
- (6) Regulated investment companies and real estates investment trusts subject to tax under subchapter M of chapter 1.
- (7) Unincorporated business enterprises subject to tax as corporations under section 1361.

