and ''corporate charter or bylaws'' are to be disregarded.

(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 4082, Apr. 28, 1962, as amended by T.D. 6928, 32 FR 13221, Sept. 19, 1967; T.D. 7767, 46 FR 11265, Feb. 6, 1981]

§ 1.856–2 Limitations.

(a) *Effective date.* The provisions of part II, subchapter M, chapter 1 of the Code, and the regulations thereunder apply only to taxable years of a real estate investment trust beginning after December 31, 1960.

(b) *Election.* Under the provisions of section 856(c)(1), a trust, even though it satisfies the other requirements of part II of subchapter M for the taxable year, will not be considered a ''real estate investment trust'' for such year, within the meaning of such part II, unless it elects to be a real estate investment trust for such taxable year, or has made such an election for a previous taxable year which has not been terminated or revoked under section 856(g)(1) or (2). The election shall be made by the trust by computing taxable income as a real estate investment trust in its return for the first taxable year for which it desires the election to apply, even though it may have otherwise qualified as a real estate investment trust for a prior year. No other method of making such election is permitted. An election cannot be revoked with respect to a taxable year beginning before October 5, 1976. Thus, the failure of an organization to be a qualified real estate investment trust for a taxable year beginning before October 5, 1976, does not have the effect of revoking a prior election by the organization to be a real estate investment trust, even though the organization is not taxable under part II of subchapter M for such taxable year. See section 856(g) and §1.856–8 for rules under which an election may be revoked with respect to taxable years beginning after October 4, 1976.

(c) *Gross income requirements.* Section 856(c) (2), (3), and (4), provides that a corporation, trust, or association is not a ''real estate investment trust'' for a taxable year unless it meets certain requirements with respect to the sources of its gross income for the taxable year. In determining whether the gross income of a real estate investment trust satisfies the percentage requirements of section 856(c) (2), (3), and (4), the following rules shall apply:

(1) *Gross income.* For purposes of both the numerator and denominator in the computation of the specified percentages, the term ''gross income'' has the same meaning as that term has under section 61 and the regulations thereunder. Thus, in determining the gross income requirements under section 856(c) (2), (3), and (4), a loss from the sale or other disposition of stock, securities, real property, etc. does not enter into the computation.

(2) *Lapse of options.* Under section 856(c)(6)(C), the term ''interests in real property'' includes options to acquire land or improvements thereon, and options to acquire leaseholds of land and improvements thereon. However, where a corporation, trust, or association writes an option giving the holder the right to acquire land or improvements thereon, or writes an option giving the holder the right to acquire a leasehold of land or improvements thereon, any income that the corporation, trust, or association recognizes because the option expires unexercised is not considered to be gain from the sale or other disposition of real property (including interests in real property) for purposes of section 856(c) (2)(D) and (3)(C). The rule in the preceding sentence also applies for purposes of section 856(c)(4)(C) in determining gain from the sale or other disposition of real property for the 30-percent-of-gross-income limitation.

(3) *Commitment fees.* For purposes of section 856(c) (2)(G) and (3)(G), if consideration is received or accrued for an agreement to make a loan secured by a mortgage covering both real property and other property, or for an agreement to purchase or lease both real

property and other property, an apportionment of the consideration is required. The apportionment of consideration received or accrued for an agreement to make a loan secured by a mortgage covering both real property and other property shall be made under the principles of §1.856–5(c), relating to the apportionment of interest income.

(4) *Holding period of property.* For purposes of the 30-percent limitation of section 856(c)(4), the determination of the period for which property described in such section has been held is governed by the provisions of section 1223 and the regulations thereunder.

(5) *Rents from real property and interest.* See §§1.856–4 and 1.856–5 for rules relating to rents from real property and interest.

(d) *Diversification of investment requirements*—(1) *75-percent test.* Section 856(c)(5)(A) requires that at the close of each quarter of the taxable year at least 75 percent of the value of the total assets of the trust be represented by one or more of the following:

(i) Real estate assets;

(ii) Government securities; and

(iii) Cash and cash items (including receivables).

For purposes of this subparagraph the term ''receivables'' means only those receivables which arise in the ordinary course of the trust's operation and does not include receivables purchased from another person. Subject to the limitations in section 856(c)(5)(B) and subparagraph (2) of this paragraph, the character of the remaining 25 percent (or less) of the value of the total assets is not restricted.

(2) *Limitations on certain securities.* Under section 856(c)(5)(B), not more than 25 percent of the value of the total assets of the trust may be represented by securities other than those described in section 856(c)(5)(A). The ownership of securities under the 25-percent limitation in section 856(c)(5)(B) is further limited in respect of any one issuer to an amount not greater in value than 5 percent of the value of the total assets of the trust and to not more than 10 percent of the outstanding voting securities of such issuer. Thus, if the real estate investment trust meets the 75-percent asset diversification requirement in section 856(c)(5)(A), it will also meet the first test under section 856(c)(5)(B) since it will, of necessity, have not more than 25 percent of its total assets represented by securities other than those described in section 856(c)(5)(A). However, the trust must also meet two additional tests under section 856(c)(5)(B), i.e. it cannot own the securities of any one issuer in an amount (i) greater in value than 5 percent of the value of the trust's total assets, or (ii) representing more than 10 percent of the outstanding voting securities of such issuer.

(3) *Determination of investment status.* The term ''total assets'' means the gross assets of the trust determined in accordance with generally accepted accounting principles. In order to determine the effect, if any, which an acquisition of any security or other property may have with respect to the status of a trust as a real estate investment trust, section 856(c)(5) requires a revaluation of the trust's assets at the end of the quarter in which such acquisition was made. A revaluation of assets is not required at the end of any quarter during which there has been no acquisition of a security or other property since the mere change in market value of property held by the trust does not, of itself, affect the status of the trust as a real estate investment trust. A change in the nature of ''cash items'', for example, the prepayment of insurance or taxes, does not constitute the acquisition of ''other property'' for purposes of this subparagraph. A real estate investment trust shall keep sufficient records as to investments so as to be able to show that it has complied with the provisions of section 856(c)(5) during the taxable year. Such records shall be kept at all times available for inspection by any internal revenue officer or employee and shall be retained so long as the contents thereof may become material in the administration of any internal revenue law.

(4) *Illustrations.* The application of section 856(c)(5) and this paragraph may be illustrated by the following examples:

Example 1. Real Estate Investment Trust M, at the close of the first quarter of its taxable year, has its assets invested as follows:

	Percent
Cash	6
Government securities	7
Real estate assets	63
Securities of various corporations (not exceeding, with respect to any one issuer, 5 percent of the value of the total assets of the trust nor 10 percent of the outstanding voting securities of such issuer)	24
Total	100

Trust M meets the requirements of section 856(c)(5) for that quarter of its taxable year.

Example 2. Real Estate Investment Trust P, at the close of the first quarter of its taxable year, has its assets invested as follows:

	Percent
Cash	6
Government securities	7
Real estate assets	63
Securities of Corporation Z	20
Securities of Corporation X	4
Total	100

Trust P meets the requirement of section 856(c)(5)(A) since at least 75 percent of the value of the total assets is represented by cash, Government securities, and real estate assets. However, Trust P does not meet the diversification requirements of section 856(c)(5)(B) because its investment in the voting securities of Corporation Z exceeds 5 percent of the value of the trust's total assets.

Example 3. Real Estate Investment Trust G, at the close of the first quarter of its taxable year, has its assets invested as follows:

	Percent
Cash	4
Government securities	9
Real estate assets	70
Securities of Corporation S	5
Securities of Corporation L	4
Securities of Corporation U	4
Securities of Corporation M (which equals 25 percent of Corporation M's outstanding voting securities)	4
Total	100

Trust G meets the 75-percent requirement of section 856(c)(5)(A), but does not meet the requirements of section 856(c)(5)(B) because its investment in the voting securities of Corporation M exceeds 10 percent of Corporation M's outstanding voting securities.

Example 4. Real Estate Investment Trust R, at the close of the first quarter of its taxable year (i.e. calendar year), is a qualified real estate investment trust and has its assets invested as follows:

Cash	$5,000
Government securities	4,000
Receivables	4,000
Real estate assets	68,000
Securities of Corporation P	4,000
Securities of Corporation O	5,000
Securities of Corporation U	5,000
Securities of Corporation T	5,000
Total assets	100,000

During the second calendar quarter the stock in Corporation P increases in value to $50,000 while the value of the remaining assets has not changed. If Real Estate Investment Trust R has made no acquisition of stock or other property during such second quarter it will not lose its status as a real estate investment trust merely by reason of the appreciation in the value of P's stock. If, during the third quarter, Trust R acquires stock of Corporation S worth $2,000, such acquisition will necessitate a revaluation of all of the assets of Trust R as follows:

Cash	$3,000
Government securities	4,000
Receivables	4,000
Real estate assets	68,000
Securities in Corporation P	50,000
Securities in Corporation O	5,000
Securities in Corporation U	5,000
Securities in Corporation T	5,000
Securities in Corporation S	2,000
Total assets	146,000

Because of the discrepancy between the value of its various investments and the 25-percent limitation in section 856(c)(5), resulting in part from the acquisition of the stock of Corporation S, Trust R, at the end of the third quarter, loses its status as a real estate investment trust. However, if Trust R, within 30 days after the close of such quarter, eliminates the discrepancy so that it meets the 25-percent limitation, the trust will be considered to have met the requirements of section 856(c)(5) at the close of the third quarter, even though the discrepancy between the value of its investment in Corporation P and the 5-percent limitation in section 856(c)(5) (resulting solely from appreciation) may still exist. If instead of acquiring stock of Corporation S, Trust R had acquired additional stock of Corporation P, then because of the discrepancy between the value of its investments and both the 5-percent and the 25-percent limitations in section 856(c)(5) resulting in part from this acquisition, trust R, at the end of the third quarter, would lose its status as a real estate investment trust, unless within 30 days after the close of such quarter both of the discrepancies are eliminated.

Example 5. If, in the previous example, the stock of Corporation P appreciates only to $10,000 during the second quarter and, in the third quarter, Trust R acquires stock of Corporation S worth $1,000, the assets as of the end of the third quarter would be as follows:

Cash	$4,000
Government securities	4,000
Receivables	4,000
Real estate assets	68,000
Securities in Corporation P	10,000

Securities in Corporation O	5,000
Securities in Corporation U	5,000
Securities in Corporation T	5,000
Securities in Corporation S	1,000
Total assets	106,000

Because the discrepancy between the value of its investment in Corporation P and the 6-percent limitation in section 856(c)(5) results solely from appreciation, and because there is no discrepancy between the value of its various investments and the 25-percent limitation, Trust R, at the end of the third quarter, does not lose its status as a real estate investment trust. If, instead of acquiring stock of Corporation S, Trust R had acquired additional stock of Corporation P worth $1,000, then, because of the discrepancy between the value of its investment in Corporation P and the 5-percent limitation resulting in part from this acquisition, Trust R, at the end of the third quarter, would lose its status as a real estate investment trust, unless within 30 days after the close of such quarter this discrepancy is eliminated.

(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 4083, Apr. 28, 1962 as amended by T.D. 7767, 46 FR 11265, Feb. 6, 1981]

§ 1.856–3 Definitions.

For purposes of the regulations under part II, subchapter M, chapter 1 of the Code, the following definitions shall apply.

(a) *Value.* The term ''value'' means, with respect to securities for which market quotations are readily available, the market value of such securities; and with respect to other securities and assets, fair value as determined in good faith by the trustees of the real estate investment trust. In the case of securities of other qualified real estate investment trusts, fair value shall not exceed market value or asset value, whichever is higher.

(b) *Real estate assets*—(1) *In general.* The term ''real estate assets'' means real property, interests in mortgages on real property (including interests in mortgages on leaseholds of land or improvements thereon), and shares in other qualified real estate investment trusts. The term ''mortgages on real property'' includes deeds of trust on real property.

(2) *Treatment of REMIC interests as real estate assets*—(i) *In general.* If, for any calendar quarter, at least 95 percent of a REMIC's assets (as determined in accordance with §1.860F–4(e)(1)(ii) or §1.6049–7(f)(3)) are real estate assets (as defined in paragraph (b)(1) of this section), then, for that calendar quarter, all the regular and residual interests in that REMIC are treated as real estate assets and, except as provided in paragraph (b)(2)(iii) of this section, any amount includible in gross income with respect to those interests is treated as interest on obligations secured by mortgages on real property. If less than 95 percent of a REMIC's assets are real estate assets, then the real estate investment trust is treated as holding directly its proportionate share of the assets and as receiving directly its proportionate share of the income of the REMIC. See §§1.860F–4(e)(1)(ii)(B) and 1.6049–7(f)(3) for information required to be provided to regular and residual interest holders if the 95-percent test is not met.

(ii) *Treatment of REMIC assets for section 856 purposes*—(A) *Manufactured housing treated as real estate asset.* For purposes of paragraphs (b) (1) and (2) of this section, the term ''real estate asset'' includes manufactured housing treated as a single family residence under section 25(e)(10).

(B) *Status of cash flow investments.* For purposes of this paragraph (b)(2), cash flow investments (as defined in section 860G(a)(6) and §1.860G–2(g)(1)) are real estate assets.

(iii) *Certain contingent interest payment obligations held by a REIT.* If a REIT holds a residual interest in a REMIC for a principal purpose of avoiding the limitation set out in section 856(f) (concerning interest based on mortgagor net profits) or section 856(j) (concerning shared appreciation provisions), then, even if the REMIC satisfies the 95-percent test of paragraph (b)(i) of this section, the REIT is treated as receiving directly the REMIC's items of income for purposes of section 856.