

nevertheless, the \$12,000 portion of the dividend (paid on March 20, 1962) which the trust elected to relate to the calendar year 1961, will not qualify as a dividend for purposes of section 34, 116, or 243.

*Example 2.* The Y Trust, a real estate investment trust, had taxable income (and earnings and profits) for the calendar year 1964 of \$100,000, and for 1965 taxable income (and earnings and profits) of \$125,000. On January 1, 1964, the trust had a deficit in its earnings and profits accumulated since February 28, 1913, of \$115,000. During the year 1964 the trust distributed to shareholders taxable dividends aggregating \$85,000. On March 5, 1965, the trust declared a dividend of \$65,000 payable to shareholders on March 31, 1965. On March 15, 1965, the Y Trust filed its Federal income tax return in which it included \$40,000 of the total dividend of \$65,000 payable to shareholders on March 31, 1965, as a dividend paid by it during the taxable year 1964. On March 31, 1965, the Y Trust distributed the entire amount of the dividend of \$65,000 declared on March 5, 1965. The election under section 858(a) is valid only to the extent of \$15,000, the amount of the undistributed earnings and profits for 1964 (\$100,000 earnings and profits less \$85,000 distributed during 1964). The remainder (\$50,000) of the \$65,000 dividend paid on March 31, 1965, could not be the subject of an election, and such amount will be regarded as a distribution by the Y Trust out of earnings and profits for the taxable year 1965. Assuming that the only other distribution by the Y Trust during 1965 was a distribution of \$75,000 paid as a dividend on October 31, 1965, the total amount of the distribution of \$65,000 paid on March 31, 1965, is to be treated by the shareholders as taxable dividends for the taxable year in which such dividend is received. The Y Trust will treat the amount of \$15,000 as a distribution of the earnings or profits of the trust for the taxable year 1964, and the remaining \$50,000 as a distribution of the earnings or profits for the year 1965. The distribution of \$75,000 on October 31, 1966, is, of course, a taxable dividend out of the earnings and profits for the year 1965.

*Example 3.* Assume the facts are the same as in example 2, except that the taxable years involved are calendar years 1977 and 1978, and Y Trust specified in its Federal income tax return for 1977 that the dollar amount of \$40,000 of the \$65,000 distribution payable to shareholders on March 31, 1978, is to be treated as having been paid in 1977. The result will be the same as in example 2, since the amount of the undistributed earnings and profits for 1977 is less than the \$40,000 amount specified by Y Trust in making its election. Accordingly, the election is valid only to the extent of \$15,000. Y Trust will treat the amount of \$15,000 as a distribution, in 1977, of earnings and profits of the trust for the taxable year 1977 and the remaining

\$50,000 as a distribution, in 1978, of the earnings and profits for 1978.

(e) *Notice to shareholders.* Section 858(c) provides that, in the case of dividends with respect to which a real estate investment trust has made an election under section 858(a), any notice to shareholders required under part II, subchapter M, chapter 1 of the Code, 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. Thus, the notice requirement of section 857(b)(3)(C) and paragraph (f) of § 1.857-6 with respect to capital gains dividends may be satisfied with respect to amounts to which section 858(a) and this section apply if the notice relating to such amounts is mailed to the shareholders not later than 30 days after the close of the taxable year in which the distribution is made. If the notice under section 858(c) relates to an election with respect to any capital gains dividends, such capital gains dividends shall be aggregated by the real estate investment trust with the designated capital gains dividends actually paid during the taxable year to which the election applies (not including deficiency dividends or dividends with respect to which an election has been made for a prior taxable year under section 858) to determine whether the aggregate of the designated capital gains dividends with respect to such taxable year exceeds the net capital gain of the trust. See section 857(b)(3)(C) and paragraph (f) of § 1.857-6.

(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 4089, Apr. 28, 1962, as amended by T.D. 7767, 46 FR 11279, Feb. 6, 1981]

#### § 1.860-1 Deficiency dividends.

Section 860 allows a qualified investment entity to be relieved from the

payment of a deficiency in (or to be allowed a credit or refund of) certain taxes. “Qualified investment entity” is defined in section 860(b). The taxes referred to are those imposed by sections 852(b) (1) and (3), 857(b) (1) or (3), the minimum tax on tax preferences imposed by section 56 and, if the entity fails the distribution requirements of section 852(a)(1)(A) or 857(a)(1) (as applicable), the corporate income tax imposed by section 11(a) or 1201(a). The method provided by section 860 is to allow an additional deduction for a dividend distribution (that meets the requirements of section 860 and § 1.860-2) in computing the deduction for dividends paid for the taxable year for which the deficiency is determined. A deficiency dividend may be an ordinary dividend or, subject to the limitations of sections 852(b)(3)(C), 857(b)(3)(C), and 860(f)(2)(B), may be a capital gain dividend.

(Sec. 7805, 68A Stat. 917; 26 U.S.C. 7805; sec. 860(e) (92 Stat. 2849, 26 U.S.C. 860(e)); sec. 860(g) (92 Stat. 2850, 26 U.S.C. 860(g)))

[T.D. 7936, 49 FR 2107, Jan. 18, 1984]

**§ 1.860-2 Requirements for deficiency dividends.**

(a) *In general*—(1) *Determination, etc.* A qualified investment entity is allowed a deduction for a deficiency dividend only if there is a determination (as defined in section 860(e) and paragraph (b)(1) of this section) that results in an adjustment (as defined in section 860(d) (1) or (2)) for the taxable year for which the deficiency dividend is paid. An adjustment does not include an increase in the excess of (i) the taxpayer’s interest income excludable from gross income under section 103(a) over (ii) its deductions disallowed under sections 265 and 171(a)(2).

(2) *Payment date and claim.* The deficiency dividend must be paid on, or within 90 days after, the date of the determination and before the filing of a claim under section 860(g) and paragraph (b)(2) of this section. This claim must be filed within 120 days after the date of the determination.

(3) *Nature and amount of distribution.* (i) The deficiency dividend must be a distribution of property (including money) that would have been properly taken into account in computing the

dividends paid deduction under section 561 for the taxable year for which tax liability resulting from the determination exists if the property had been distributed during that year. Thus, if the distribution would have been a dividend under section 316(a) if it had been made during the taxable year for which the determination applies, and the distribution may qualify under sections 316(b)(3), 562(a), and 860(f)(1), even though the distributing corporation, trust, or association has no current or accumulated earnings and profits for the taxable year in which the distribution is actually made. The amount of the distribution is determined under section 301 as of the date of the distribution.

The amount of the deduction is subject to the applicable limitations under sections 562 and 860(f)(2). Thus, if the entity distributes to an individual shareholder property (other than money) which on the date of the distribution has a fair market value in excess of its adjusted basis in the hands of the entity, the amount of the deficiency dividend in the individual’s hands for purposes of section 316(b)(3) is determined by using the property’s fair market value on that date. Nevertheless, the amount of the deficiency dividend the entity may deduct is limited, under § 1.562-1(a), to the adjusted basis of the property and the amount taxable to the individual as a dividend is determined by reference to the current and accumulated earnings and profits for the year to which the determination applies.

(ii) The qualified investment entity does not have to distribute the full amount of the adjustment in order to pay a deficiency dividend. For example, assume that in 1983 a determination with respect to a calendar year regulated investment company results in an increase of \$100 in investment company taxable income (computed without the dividends paid deduction) for 1981 and no other change. The regulated investment company may choose to pay a deficiency dividend of \$100 or of any lesser amount and be allowed a dividends paid deduction for 1981 for the amount of that deficiency dividend.

(4) *Status of distributor.* The corporation, trust, or association that pays the