



# Instructions for Form 1120-REIT

## U.S. Income Tax Return for Real Estate Investment Trusts

(Section references are to the Internal Revenue Code unless otherwise noted.)

### Paperwork Reduction Act Notice

We ask for this information to carry out the Internal Revenue laws of the United States. We need it to ensure that taxpayers are complying with these laws and to allow us to figure and collect the right amount of tax. You are required to give us this information.

### General Instructions

**Note:** In addition to those publications listed throughout these instructions, taxpayers may wish to get: **Publication 534, Depreciation**; **Publication 535, Business Expenses**; **Publication 542, Tax Information on Corporations**; and **Publication 921, Explanation of the Tax Reform Act of 1986 for Business**.

#### A. Purpose of Form

Form 1120-REIT is used to report the income, gains, losses, deductions, and credits of real estate investment trusts as defined in section 856.

#### B. Filing Form 1120-REIT

##### 1. Who Must File

A corporation, trust, or association that elects to be treated as a real estate investment trust for the tax year (or has made such election for a prior tax year and such election has not been terminated or revoked) and that meets the requirements listed below must file Form 1120-REIT. The election is made by computing taxable income as a real estate investment trust on Form 1120-REIT.

An electing real estate investment trust must be a corporation, trust, or association:

- (a) that is managed by one or more trustees or directors;
- (b) the beneficial ownership of which is evidenced by transferable shares, or by transferable certificates of beneficial interest;
- (c) that would otherwise be taxed as a domestic corporation;
- (d) that is neither a financial institution referred to in section 582(c)(5), nor an insurance company to which subchapter L applies;
- (e) the beneficial ownership of which is held by 100 or more persons (except this rule does not apply for the first tax year in which the election is made to be taxed as a real estate investment trust);
- (f) that is not closely held, as defined in section 856(h) (except this rule does not apply for the first tax year in which the election is made to be taxed as a real estate investment trust);

(g) that meets the gross income and diversification of investment requirements of section 856(c);

(h) that was treated as a real estate investment trust for all tax years beginning after February 28, 1986, or as of the end of the tax year, the corporation, trust, or association had no accumulated earnings and profits from any non-REIT year;

(i) that keeps the records required by Regulations section 1.857-8 to show the actual ownership of its outstanding stock or certificates of beneficial interest during the tax year;

(j) that has a tax year which is a calendar year, unless such corporation, trust, or association was considered to be a real estate investment trust for any tax year beginning on or before October 4, 1976; and

(k) for which the deduction for dividends paid (excluding any net capital gain dividends) equals or exceeds:

(1) the sum of:

(i) 95% of its real estate investment trust taxable income (determined without regard to the deduction for dividends paid and by excluding any net capital gain); and

(ii) 95% of the excess of its net income from foreclosure property over the tax imposed on such income by section 857(b)(4)(A);

(2) minus any excess noncash income as determined under section 857(e).

See sections 856 and 857 for details and exceptions.

**Note:** For income tax purposes, a corporation that is a qualified REIT subsidiary is not treated as a separate corporation. See section 856(i) for details.

##### 2. Termination of Election

Once the election to be treated as a real estate investment trust is made, it stays in effect for all years until it is terminated or revoked. The election terminates automatically for any tax year in which the corporation, trust, or association is not a qualified real estate investment trust as defined in section 856.

The election may also be revoked by the taxpayer for any tax year after the first year for which the election is effective by filing a statement with the Internal Revenue Service Center where the corporation, trust, or association files its income tax return. The statement must be filed on or before the 90th day after the first day of the tax year for which the revocation is to be effective. The statement must be signed by an official authorized to sign the income tax return of the taxpayer and must contain the name, address, and employer identification number of the taxpayer, specify the tax year

for which the election was made, and state that the taxpayer, pursuant to section 856(g)(2), revokes its election under section 856(c)(1) to be a real estate investment trust.

During the 4 years after the first year for which the termination or revocation is effective, the corporation, trust, or association may not make a new election to be taxed as a real estate investment trust, except as provided in section 856(g)(4).

##### 3. When To File

Generally, a real estate investment trust must file its income tax return by the 15th day of the 3rd month after the end of the tax year. A new real estate investment trust filing a short-period return must generally file by the 15th day of the 3rd month after the short period ends. A real estate investment trust that has dissolved must generally file by the 15th day of the 3rd month after the date it dissolved.

**Extension.**—File Form 7004, Application for Automatic Extension of Time To File Corporation Income Tax Return, to request an automatic 6-month extension of time to file.

**Period covered.**—File the 1987 return for calendar year 1987 and fiscal years that begin in 1987 and end in 1988. For a fiscal year, fill in the tax year space at the top of the form.

**Final return.**—If the real estate investment trust ceases to exist, check the box for Final Return in item F at the top of the form.

##### 4. Where To File

Use the preaddressed envelope. If you do not use the envelope, file your return at the applicable IRS address listed below.

If the real estate investment trust's principal business, office, or agency is located in	Use the following Internal Revenue Service Center address
New Jersey, New York (New York City, and counties of Nassau, Rockland, Suffolk, and Westchester)	Holtsville, NY 00501
New York (all other counties), Connecticut, Maine, Massachusetts, Minnesota, New Hampshire, Rhode Island, Vermont	Andover, MA 05501
Alabama, Florida, Georgia, Mississippi, South Carolina	Atlanta, GA 39901
Kentucky, Michigan, Ohio, West Virginia	Cincinnati, OH 45999
Kansas, Louisiana, New Mexico, Oklahoma, Texas	Austin, TX 73301
Alaska, Arizona, California (counties of Alpine, Amador, Butte, Calaveras, Colusa, Contra Costa, Del Norte, El Dorado, Glenn, Humboldt, Lake, Lassen, Marin, Mendocino, Modoc, Napa, Nevada, Placer, Plumas, Sacramento, San Joaquin, Shasta, Sierra, Siskiyou, Solano, Sonoma, Sutter, Tehama, Trinity, Yolo, and	Ogden, UT 84201

(continued on next page)

Yuba), Colorado, Idaho, Montana, Nebraska, Nevada, North Dakota, Oregon, South Dakota, Utah, Washington, Wyoming	Ogden, UT 84201
California (all other counties), Hawaii	Fresno, CA 93888
Illinois, Iowa, Missouri, Wisconsin	Kansas City, MO 64999
Arkansas, Indiana, North Carolina, Tennessee, Virginia	Memphis, TN 37501
Delaware, District of Columbia, Maryland, Pennsylvania	Philadelphia, PA 19255

Real estate investment trusts having their principal place of business outside the United States must file with the Internal Revenue Service Center, Philadelphia, PA 19255.

## 5. Signature

The return must be signed and dated by the president, vice president, treasurer, assistant treasurer, chief accounting officer, or any other corporate officer (such as tax officer) authorized to sign. A receiver, trustee, or assignee must sign and date any return required to be filed on behalf of a real estate investment trust.

If a corporate officer filled in the real estate investment trust tax return, the Paid Preparer's space under "Signature of officer" should remain blank. If someone prepares the tax return and does not charge the real estate investment trust, that person should not sign the return. Certain others who prepare the tax return should not sign. For example, a regular, full-time employee of the real estate investment trust, such as a clerk, secretary, etc., does not have to sign.

Generally, anyone who is paid to prepare the tax return must sign it and fill in the blanks in the Paid Preparer's Use Only area of the return.

The preparer required to sign the return MUST complete the required preparer information and:

- Sign it, by hand, in the space provided for the preparer's signature. (Signature stamps or labels are not acceptable.)
- Give a copy of the tax return to the taxpayer in addition to the copy filed with IRS.

Tax return preparers should be familiar with their responsibilities. See **Publication 1045**, Information for Tax Practitioners, for more details.

## C. Figuring and Paying the Tax

### 1. Accounting

**Accounting methods.**—Taxable income must be computed using the method of accounting regularly used in keeping the real estate investment trust's books and records. In all cases, the method adopted must clearly reflect taxable income. See section 446.

Generally, real estate investment trusts with average annual gross receipts of more than \$5,000,000 must use the accrual method of accounting. See section 448 for definitions and exceptions.

Unless the law specifically permits otherwise, the real estate investment trust may change the method of accounting used to report taxable income in earlier years (for income as a whole or for any material item) only by first getting consent on **Form 3115**,

Application for Change in Accounting Method. Also see **Publication 538**, Accounting Periods and Methods.

**Change in accounting period.**—A real estate investment trust may not change its accounting period to any accounting period other than the calendar year. Generally, before changing its accounting period, the real estate investment trust must obtain the Commissioner's approval by filing **Form 1128**, Application for Change in Accounting Period. (See Regulations section 1.442-1 and Publication 538.) However, upon electing to be taxed as a real estate investment trust, an entity that has not engaged in any active trade or business may change its accounting period to a calendar year without the approval of the Commissioner.

### 2. Rounding Off to Whole-Dollar Amounts

The real estate investment trust may show the money items on the return and accompanying schedules as whole-dollar amounts. To do so, drop any amount less than 50 cents and increase any amount from 50 cents through 99 cents to the next higher dollar.

### 3. Depository Method of Tax Payment

The real estate investment trust must pay the tax due in full when the return is filed but no later than 2½ months after the end of the tax year.

Deposit real estate investment trust income tax payments (and estimated tax payments) with **Form 8109**, Federal Tax Deposit Coupon. Be sure to darken the "1120" box on the coupon. Make these deposits with either a financial institution qualified as a depository for Federal taxes or the Federal Reserve bank or branch servicing the geographic area where the real estate investment trust is located. Do not submit deposits directly to an IRS office; otherwise, the real estate investment trust may be subject to a failure to deposit penalty. Records of deposits will be sent to IRS for crediting to the real estate investment trust's account. See the instructions contained in the coupon book (Form 8109) for more information.

In order for us to better process your deposits, please write on your check your employer identification number, type of tax paid, and the tax period to which the deposit applies.

To get more deposit coupons, use the reorder form (Form 8109A) provided in the coupon book.

For more information concerning deposits, see **Publication 583**, Information for Business Taxpayers.

### 4. Backup Withholding

If a person receives certain payments and does not give the payer the correct employer identification number, the payer will withhold taxes from those payments. This type of withholding is called "backup withholding." If the real estate investment trust has had any backup withholding withheld from payments, it should show this amount in the blank space in the right-hand column between lines 23 and 24, page 1, Form 1120-REIT, and label the amount as backup withholding. The real estate investment trust should then include the amount in the total for line 24.

## 5. Estimated Tax

A real estate investment trust must make estimated tax payments if it can expect its estimated tax to be \$40 or more. For estimated tax purposes, the estimated tax of the real estate investment trust is defined as the sum of its **alternative minimum tax and environmental tax** (minus the credits for Federal tax on gasoline and special fuels and overpaid windfall profit tax). Use the Payment Coupons (Forms 8109) in making deposits of estimated tax.

If the real estate investment trust overpaid estimated tax, it may be able to get a "quick refund" by filing **Form 4466**, Corporation Application for Quick Refund of Overpayment of Estimated Tax. The overpayment must be both: (1) at least 10% of expected income tax liability, and (2) at least \$500. To apply, file Form 4466 within 2½ months after the end of the tax year and before the real estate investment trust files its tax return.

**Caution:** Pending legislation would exempt real estate investment trusts from the imposition of the environmental tax. If this provision becomes law, the requirement to make payments of estimated tax will no longer apply to real estate investment trusts.

### 6. Timing Change in Deducting Accrued Expenses

Generally, an accrual basis taxpayer can deduct accrued expenses in the tax year that all events have occurred that determine the liability, and the amount of the liability can be figured with reasonable accuracy. However, all the events that establish liability for the amount generally are treated as occurring only when economic performance takes place. There are exceptions for recurring items. See section 461(h).

### 7. Rule of 78's Not an Acceptable Method of Figuring Interest

Taxpayers are reminded that, generally, the Rule of 78's is not an acceptable method for computing interest income or expense. Anyone using the Rule of 78's should see Revenue Procedures 84-27, 84-28, 84-29 and 84-30 (which are in Cumulative Bulletin 1984-1) to change their method.

## D. Interest and Penalties

**1. Interest.**—Interest is charged on taxes not paid by the due date, even if an extension of time to file is granted. Interest is also charged on penalties imposed for failure to file, gross valuation overstatements, and substantial understatements of tax from the due date (including extensions) to the date of payment. The interest charge is figured at a rate determined under section 6621.

**2. Late Filing of Return.**—A real estate investment trust that fails to file its return when due (including extensions of time for filing) may be subject to a penalty of 5% a month or fraction of a month, up to a maximum of 25%, for each month the return is not filed. The penalty is imposed on the net amount due. The minimum penalty for failure to file a tax return within 60 days of the due date for filing (including extensions) is the lesser of the underpayment of tax or \$100.

**3. Late Payment of Tax.**—Generally, the penalty for not paying tax when due is ½% of the unpaid amount, up to a maximum of

25%, for each month or fraction of a month the tax remains unpaid. The penalty is imposed on the net amount due.

**4. Underpayment of Estimated Tax.**—A real estate investment trust that fails to pay estimated tax payments when due may be subject to an underpayment penalty for the period of underpayment. To avoid the estimated tax penalty, the real estate investment trust must make estimated tax payments of at least 90% of the sum of its alternative minimum tax and environmental tax (minus the credits for Federal tax on gasoline and special fuels and overpaid windfall profit tax) as shown on the return. See sections 6655(b)(1) and (d)(3).

If the real estate investment trust underpaid estimated tax, attach **Form 2220**, Underpayment of Estimated Tax by Corporations, to show either how the penalty was figured or the exceptions which apply. Also be sure to check the box on line 25, Form 1120-REIT. If the real estate investment trust owes a penalty, enter the amount of the penalty on this line.

**5. Overstated Tax Deposits.**—If deposits are overstated, the real estate investment trust may be subject to a penalty of 25% of the overstated deposit claim. See section 6656(b).

**6. Other Penalties.**—There are also penalties that can be imposed for negligence, substantial understatement of tax, and fraud. See sections 6653 and 6661.

## E. Other Forms, Returns, Schedules, and Statements That May Be Required

### 1. Forms

The real estate investment trust may have to file any of the following:

**Forms W-2 and W-3.** Wage and Tax Statement; and Transmittal of Income and Tax Statements.

**Form W-2P.** Statement for Recipients of Annuities, Pensions, Retired Pay, or IRA Payments.

**Form 966.** Corporate Dissolution or Liquidation.

**Forms 1042 and 1042S.** Annual Withholding Tax Return for U.S. Source Income of Foreign Persons; and Foreign Person's U.S. Source Income Subject to Withholding. Use these forms to report and transmit withheld tax on payments or distributions made to nonresident alien individuals, foreign partnerships, or foreign corporations to the extent such payments or distributions constitute gross income from sources within the U.S. (see sections 861 through 865). For more information, see sections 1441 and 1442, and **Publication 515**, Withholding of Tax on Nonresident Aliens and Foreign Corporations.

**Form 1096.** Annual Summary and Transmittal of U.S. Information Returns.

**Form 1098.** Mortgage Interest Statement. This form is used to report the receipt from any individual of \$600 or more of mortgage interest in the course of the recipient's trade or business for any calendar year.

**Forms 1099-A, B, DIV, INT, MISC, OID, PATR, and R.** Information returns for reporting abandonments, acquisitions through foreclosure, proceeds from brokers and barter exchange transactions, real

estate transactions, certain dividends and distributions, interest payments, medical and dental health care payments, miscellaneous income payments, nonemployee compensation, original issue discount, patronage dividends, and total distributions from profit-sharing plans, retirement plans, and individual retirement arrangements. Also use these returns to report amounts that were received as a nominee on behalf of another person.

For more information, see **Publication 916**, Information Returns.

**Note:** *Every real estate investment trust must file information returns if, in the course of its trade or business, it makes payments of rents, commissions, or other fixed or determinable income (see section 6041) totalling \$600 or more to any one person during the calendar year.*

**Form 5452.** Corporate Report of Nontaxable Dividends.

**Form 5498.** Individual Retirement Arrangement Information. Use this form to report contributions (including rollover contributions) to an individual retirement arrangement (IRA) and the value of an IRA or simplified employee pension account.

**Form 5713.** International Boycott Report, for persons having operations in or related to "boycotting" countries. In addition, persons who participate in or cooperate with an international boycott may have to complete Schedule A or Schedule B and Schedule C of Form 5713 to compute their loss of the following items: the foreign tax credit, the deferral of earnings of a controlled foreign corporation, IC-DISC benefits, and FSC benefits.

**Form 8281.** Information Return for Publicly Offered Original Issue Discount Instruments. This form is generally required to be filed by issuers of public offerings of debt instruments within 30 days of the issuance of the debt instrument.

**Forms 8288 and 8288-A.** U.S. Withholding Tax Return for Dispositions by Foreign Persons of U.S. Real Property Interests; and Statement of Withholding on Dispositions by Foreign Persons of U.S. Real Property Interests. Use these forms to report and transmit withheld tax on the sale of U.S. real property by a foreign person. However, with respect to distributions described in Temporary Regulations section 1.1445-8T, use Forms 1042 and 1042S. See section 1445 and the related regulations for additional information.

**Form 8300.** Report of Cash Payments Over \$10,000 Received in a Trade or Business. Generally, this form is used to report the receipt of more than \$10,000 in cash or foreign currency in one transaction (or a series of related transactions).

**Form 8612.** Return of Excise Tax on Undistributed Income of Real Estate Investment Trusts. If you are liable for the 4% excise tax on undistributed income imposed under section 4981, you must file this return for calendar years beginning after 1986.

### 2. Statements

**Stock ownership in foreign corporations.**—Attach the required statement to Form 1120-REIT if the real estate investment trust owned 5% or more in value of the outstanding stock of a foreign personal holding company and the

real estate investment trust was required to include in its gross income any undistributed foreign personal holding company income. See section 551(c).

A real estate investment trust that controls a foreign corporation, or that is a 10%-or-more shareholder of a controlled foreign corporation, or acquires, disposes of, or owns 5% or more ownership in the outstanding stock of a foreign corporation may have to file **Form 5471**, Information Return with Respect to a Foreign Corporation.

A real estate investment trust that is engaged in a trade or business in the United States and is controlled by a foreign person may have to file **Form 5472**, Information Return of a Foreign Owned Corporation.

**Transfers to a corporation controlled by the transferor.**—If a person receives stock or securities of a corporation in exchange for property, and no gain or loss is recognized under section 351, that person (transferor) and the transferee must attach to Form 1120-REIT the information required by Regulations section 1.351-3.

### 3. Amended Return

To correct any error in a previously filed Form 1120-REIT, file an amended Form 1120-REIT and check the box for Amended Return in item F at the top of the form.

### 4. Attachments

Attach **Form 4136**, Computation of Credit for Federal Tax on Gasoline and Special Fuels, after page 4, Form 1120-REIT. Attach schedules in alphabetical order and other forms in numerical order after Form 4136.

In order to process the return, we ask that you complete every applicable entry space on Form 1120-REIT. Please do not attach statements and write "See attached" in lieu of completing the entry spaces on Form 1120-REIT.

If more space is needed on the forms or schedules, attach separate sheets indicating at the top of each attachment the form number or schedule letter of the form or schedule being continued. Also, show the same information called for on the form in the same order as on the printed forms. Be sure to show the totals on the printed forms. Please use sheets that are the same size as the forms and schedules. Attach these separate sheets after all the schedules and forms. Also, put the real estate investment trust's employer identification number (EIN) on each sheet.

### F. Additional Information

Be sure to answer questions G through Q on page 3, Form 1120-REIT. The instructions that follow are keyed to these questions.

#### 1. Question H(2)(c)

**U.S. person.**—The term "U.S. person" means:

1. A citizen or resident of the United States;
2. A domestic partnership;
3. A domestic corporation;
4. Any estate or trust (other than a foreign estate or trust within the meaning of section 7701(a)(31)).

"Owner's country," for individuals, is the owner's country of residence. For all others, it is the country where incorporated, organized, created, or administered.

## 2. Question J

**Foreign financial accounts.**—Check the Yes box if either **a** or **b**, below, applies to the real estate investment trust; otherwise, check the No box:

**a.** At any time during the year the real estate investment trust had an interest in or signature or other authority over a financial account in a foreign country (such as a bank account, securities account, or other financial account);

AND

- The combined value of the accounts was more than \$10,000 at any time during the year; AND
- The account was NOT with a U.S. military banking facility operated by a U.S. financial institution.

**b.** The real estate investment trust owns more than 50% of the stock in any corporation that would answer “Yes” to item **a** above.

Get form **TD F 90-22.1**, Report of Foreign Bank and Financial Accounts, to see if the real estate investment trust is considered to have an interest in or signature or other authority over a financial account in a foreign country (such as a bank account, securities account, or other financial account).

If Yes is checked for this question, file form TD F 90-22.1 by June 30, 1988, with the Department of the Treasury at the address shown on the form. Form TD F 90-22.1 is not a tax return, so do not file it with Form 1120-REIT.

Form TD F 90-22.1 may be obtained from IRS Forms Distribution Centers.

Also, if Yes is checked for this question, write the name of the foreign country or countries. Attach a separate sheet if more space is needed.

## 3. Question P

**Tax-exempt interest.**—Report any tax-exempt interest received or accrued in the space provided. Include any exempt-interest dividends received as a shareholder in a mutual fund or other regulated investment company.

## Specific Instructions

**Employer identification number.**—If the employer identification number (EIN) on the label is wrong or if the real estate investment trust did not receive a label, enter the correct number at the top of the return.

A real estate investment trust that does not have an EIN should apply for one on **Form SS-4**, Application for Employer Identification Number. This form may be obtained from most IRS and Social Security Administration offices. Send Form SS-4 to the same Internal Revenue Service Center to which Form 1120-REIT is mailed. If the EIN has not been received by the filing time for the real estate investment trust tax return, write “Applied for” in the space for the EIN.

For more information concerning an EIN, see Publication 583.

**Date REIT established.**—If the real estate investment trust is a corporation under state or local law, enter the date incorporated. If a trust or association, enter the date organized.

## Page 4

**Total assets.**—Enter the total assets of the real estate investment trust as of the end of the tax year. If there are no assets at the end of the tax year, enter the total assets as of the beginning of the tax year.

## Part I

In this part, do not include income or deductions attributable to any prohibited transaction (as defined in section 857(b)(6)) resulting in a gain. In addition, exclude gross income, gains, losses, and deductions from foreclosure property (as defined in section 856(e)) if the aggregate of such amounts results in a positive amount of net income. To report these items of income and deduction, see the instructions for Parts II and IV.

## Income

### Line 1

#### Dividends

Enter the total amount of dividends received during the tax year.

### Line 2

#### Interest

Enter interest on U.S. obligations and on loans, notes, mortgages, bonds, bank deposits, corporate bonds, tax refunds, etc.

Do not offset interest expense against interest income.

### Line 3

#### Gross rents from real property

Enter the gross amount received for the rental of real property. Such term includes charges for services customarily furnished or rendered in connection with the rental of real property and rent attributable to personal property leased under or in connection with a lease of real property (provided the rent attributable to such personal property does not exceed 15% of the total rent for the tax year charged for both the real and personal property under such lease). See section 856(d)(2) for amounts excluded from the term “rents from real property.”

### Line 4

#### Other gross rents

Enter the gross amount received for the rental of property not included on line 3.

### Line 5

#### Capital gain net income

Every sale or exchange of a capital asset must be reported in detail on **Schedule D (Form 1120)**, Capital Gains and Losses, even though no gain or loss is indicated.

If your tax year begins before July 1, 1987, and the net long-term capital gain exceeds the net short-term capital loss, compute the alternative tax to see if it produces a smaller tax.

### Line 6

#### Net gain (or loss)

Enter the net gain (or loss) from **Form 4797**, Gains and Losses From Sales or Exchanges of Assets Used in a Trade or Business and Involuntary Conversions, Part II, line 18.

### Line 7

#### Other income

Enter any other taxable income not listed above, except amounts that must be reported in Parts II or IV, and explain its

nature on an attached schedule. Examples of other income are amounts received or accrued as consideration for entering into agreements to make real property loans or to purchase or lease real property; recoveries of bad debts deducted in prior years under the specific charge-off method; the amount of credit for alcohol used as fuel (determined without regard to the limitation based on tax) that was entered on **Form 6478**, Credit for Alcohol Used as Fuel; and refunds of taxes deducted in prior years to the extent it reduced income subject to tax in the year deducted (see section 111). Do not offset current year's taxes with tax refunds.

If “other income” consists of only one item, explain what it is in parentheses on line 7.

## Deductions

### Limitations on deductions.—

**1.** Transactions between related taxpayers. Generally, an accrual basis taxpayer may only deduct business expenses and interest owed to a related party in the year the payment is included in the income of the related party. See section 267 for limitation on deductions for unpaid expenses and interest.

**2.** Direct and indirect costs (including taxes) allocable to real or tangible personal property constructed or improved by the taxpayer. Such costs must be capitalized in accordance with section 263A.

**3.** Golden parachute payments. A portion of the payments made by a corporation to key personnel that exceeds their usual compensation may not be deductible. This occurs when the corporation has an agreement (golden parachute) with these key employees to pay them these excessive amounts if control of the corporation changes. See section 280G.

**4.** Business startup expenses are required to be capitalized unless an election is made to amortize over a period of 60 months. See section 195.

### Line 10

#### Salaries and wages

Enter on line 10a the amount of total salaries and wages paid or incurred for the tax year. Do not include salaries and wages deducted elsewhere on the return, such as contributions to a simplified employee pension plan.

**Caution:** If you provided taxable fringe benefits to your employees, such as personal use of a car, do not deduct as wages the amount allocated for depreciation and other expenses that you claimed on lines 16 and 18.

Enter on line 10b the amount of jobs credit from **Form 5884**, Jobs Credit.

### Line 11

#### Repairs

Enter the cost of incidental repairs, such as labor and supplies, that do not add to the value of the property or appreciably prolong its life.

### Line 12

#### Bad debts

Enter the total debts that became worthless in whole or in part during the tax year.

The reserve method of computing bad debts has been repealed for tax years.

beginning after 1986. If the real estate investment trust maintained such a reserve for its last tax year beginning before 1987, it must include the balance remaining in the reserve in income ratably over a 4-year period. Include the amount reportable as income in 1987 on line 7, page 1, and attach a computation. The change from the reserve method to the specific charge-off method is treated as a change in accounting method and shall be considered as approved by the Commissioner.

## Line 14

### Taxes

Enter taxes paid or incurred during the tax year, but do not include the following:

1. Federal income taxes;
2. Foreign or U.S. possession income taxes if a tax credit is claimed;
3. Taxes, including state or local sales taxes, that are paid or incurred in connection with an acquisition or disposition of property (such taxes must be treated as a part of the cost of the acquired property or, in the case of a disposition, as a reduction in the amount realized on the disposition);
4. Excise taxes imposed under section 4981 on undistributed real estate investment trust income; or
5. Taxes not imposed on the real estate investment trust.

See section 164(d) for apportionment of taxes on real property between seller and purchaser.

## Line 15

### Interest

Do not include interest on indebtedness incurred or continued to purchase or carry obligations on which the interest is wholly exempt from tax.

Generally, a cash basis taxpayer cannot deduct prepaid interest allocable to years following the current tax year. For example, a cash basis calendar year taxpayer who in 1987 prepaid interest allocable to any period after 1987 can deduct only the amount allocable to 1987. See **Publication 545**, Interest Expense.

Generally, the interest and carrying charges on straddles cannot be deducted and must be capitalized. See section 263(g).

## Line 16

### Depreciation

Besides depreciation, include in line 16 the part of the cost that the real estate investment trust elected to expense for certain recovery property placed in service during the tax year.

The rules for depreciation for property placed in service in 1987 or later years have been changed. Effective for property placed in service after 1986, the amount the taxpayer may expense under section 179 has been raised from \$5,000 to \$10,000. See the instructions for **Form 4562**, Depreciation and Amortization, for more information.

## Line 18

### Other deductions

Include in this line contributions deductible under section 170; contributions to pension and profit-sharing plans, employee benefit programs, etc.; and amortization of organization expenses.

If a contribution deductible under section 170 is in property other than money and the total claimed value of all property contributed exceeds \$500, real estate investment trusts (except those closely held) shall attach a schedule describing the kind of property contributed and the method used in determining its fair market value. Closely held real estate investment trusts must complete **Form 8283**, Noncash Charitable Contributions, and attach it to their returns.

Employers who maintain a pension, profit-sharing, or other funded deferred compensation plan, whether or not qualified under the Internal Revenue Code and whether or not a deduction is claimed for the current tax year, generally are required to file one of the forms described below. There are penalties for failure to file these forms on time and for overstating the pension plan deduction. See sections 6652(e) and 6659A.

**Form 5500**.—Complete this form for each plan with 100 or more participants.

**Form 5500-C or 5500-R**.—Complete the applicable form for each plan with fewer than 100 participants.

**Form 5500EZ**.—Complete this form for a one-participant plan.

Generally, a deduction may not be taken for the amount of any item or part thereof allocable to a class of exempt income.

Generally, a real estate investment trust can deduct only 80% of the amount otherwise allowable for meals and entertainment expenses. In addition, meals must not be lavish or extravagant; a bona fide business discussion must occur during, immediately before, or immediately after the meal; and your employee must be present at the meal. If a real estate investment trust claims a deduction for unallowable meal expenses, it may have to pay a penalty.

Additional limitations apply to deductions for skybox rentals, luxury water travel, convention expenses, and entertainment tickets. See section 274 and **Publication 463**, Travel, Entertainment, and Gift Expenses, for more details.

All other ordinary and necessary travel expenses paid or incurred in the trade or business of the real estate investment trust are generally fully deductible.

However, expenses paid or incurred for a facility (such as a yacht or hunting lodge) that is used for an activity that is usually considered entertainment, amusement, or recreation, are not deductible. (**Note:** *The real estate investment trust may be able to deduct the expense if the amount is treated as compensation and reported on Form W-2 for an employee or on Form 1099-MISC for an independent contractor.*)

**Note:** Do not deduct penalties imposed on real estate investment trusts such as those included in General Instruction D.

## Line 20

### Taxable income before net operating loss deduction, deduction for dividends paid, and section 857(b)(2)(E) deduction

**“At risk” rules.**—Special “at risk” rules under section 465 generally apply to closely held real estate investment trusts engaged in any activity as a trade or business or for the production of income. Such taxpayers

may have to adjust the amount on line 20. However, the “at risk” rules do not apply to: 1. holding real property (other than mineral property) placed in service by the taxpayer before 1987; 2. equipment leasing under sections 465(c)(4), (5), and (6); and 3. any qualifying business of a qualified corporation under section 465(c)(7). For more information, see section 465 and **Form 6198**, Computation of Deductible Loss From an Activity Described in Section 465(c).

**Passive activity limitations.**—Section 469 generally limits the deduction of passive activity losses and passive activity credits for real estate investment trusts that are closely held. Such taxpayers may have to adjust the amount on line 20 and the credits claimed on line 4b, Schedule J. See section 469 and **Form 8582**, Passive Activity Loss Limitations, for details.

## Line 21a

### Net operating loss deduction

The “net operating loss deduction” is the amount of the net operating loss carryovers that can be deducted in the tax year. See section 172(a). If this deduction is taken, explain its computation on an attached schedule.

If capital gain dividends are paid during any tax year, the amount of the net capital gain for such tax year (to the extent of such capital gain dividends) is excluded in determining (1) the net operating loss for the tax year, and (2) the amount of the net operating loss of any prior tax year that may be carried through such tax year to any succeeding tax year.

Generally, a real estate investment trust may carry a net operating loss over to each of the 15 years following the year of loss. Real estate investment trusts are not permitted to carry back a net operating loss to any year preceding the year of such loss. In addition, a net operating loss from a year that is not a REIT year may not be carried back to any year that is a REIT year.

After applying the net operating loss to the first tax year to which it may be carried, the portion of the loss the real estate investment trust may carry to each of the remaining tax years is the excess, if any, of the loss over the sum of the modified taxable income for each of the prior tax years to which the real estate investment trust may carry the loss. (See section 172(b).)

See section 172 and **Publication 536**, Net Operating Losses, for more information.

See section 382 for new limitations on the amount of net operating loss carryovers when there has been a change in ownership or equity for net operating losses incurred after 1986.

## Line 21b

### Deduction for dividends paid

Enter the amount from line 6, Schedule A.

## Line 21c

### Section 857(b)(2)(E) deduction

Enter the amount from Schedule J, line 3c.

## Line 24e

### Credit for overpaid windfall profit tax

A real estate investment trust that has overpaid its windfall profit tax may claim a credit on its income tax return. Use **Form 6249**, Computation of Overpaid Windfall

## Part II Tax Computation Worksheet

(a) Enter the amount from line 5, Part II, Form 1120-REIT . . . . .

(b) Multiply the amount on line (a) by 46% . . . . .

(c) Multiply the amount on line (a) by 34% . . . . .

(d) Line (b) ×  $\frac{\text{number of days in tax year before 7-1-87}}{\text{number of days in tax year}}$  . . . . .

(e) Line (c) ×  $\frac{\text{number of days in tax year after 6-30-87}}{\text{number of days in tax year}}$  . . . . .

(f) Tax on net income from foreclosure property. Add amounts on lines (d) and (e). Enter here and on line 6, Part II, Form 1120-REIT. . . . .

Profit Tax, to figure the credit. Include the amount of the credit in the total for this line. Write in the margin, next to the entry on this line, the amount of the credit and identify it as "Overpaid Windfall Profit Tax."

## Part II

Do NOT complete this part unless the aggregate of the gross income, gains, losses, and deductions from foreclosure property (as defined in section 856(e)) results in a positive amount of net income. If an overall net loss results, report the gross income, gains, losses, and deductions from foreclosure property on the appropriate lines in Part I.

Property may be treated as foreclosure property only if the property meets the requirements of section 856(e) and the real estate investment trust elects to so treat such property in the year the property was acquired. Such election must be made by the due date for filing Form 1120-REIT (including extensions) by attaching a statement indicating that the election under section 856(e) is being made and identifying the property to which the election applies. The statement must also set forth the name, address, and EIN of the real estate investment trust, the date the property was acquired, and a brief description of how the property was acquired (including the name of the person from whom the property was acquired and a description of the lease or debt with respect to which default occurred or was imminent). Once made, the election is irrevocable. See section 856(e) and Regulations section 1.856-6 for additional information.

## Line 2

### Gross income derived from foreclosure property

Do NOT include on line 2 amounts described in sections 856(c)(3)(A), (B), (C), (D), (E), or (G). These amounts must be reported in Part I.

## Line 4

### Deductions

Only those expenses which have a proximate and primary relationship to the earning of the income shown on line 3 may be deducted to arrive at net income from foreclosure property. Such deductions include depreciation on foreclosure property, interest paid or accrued on debt of the real estate investment trust that is attributable to the carrying of such property, real estate taxes, and fees charged by an independent contractor to manage such property. Do not deduct general overhead and administrative expenses in Part II.

## Line 6

### Tax on net income from foreclosure property

Real estate investment trusts whose tax year begins after June 30, 1987, enter 34% of line 5 on line 6, Part II.

Real estate investment trusts whose tax year begins before July 1, 1987, must use the Part II Tax Computation Worksheet (above) to figure the correct amount of tax to enter on line 6, Part II.

## Part III

All real estate investment trusts must complete lines 1a through 8 of this part. If line 8 is zero, the tax imposed under section 857(b)(5) does not apply and the rest of Part III should not be completed. If line 8 is greater than zero, complete all of Part III and enter the tax from line 16 on Schedule J, line 3c.

**Caution:** If line 8 is greater than zero, the real estate investment trust **MUST:**

(a) attach a schedule to Form 1120-REIT listing the nature and amount of each item of its gross income described in sections 856(c)(2) and (3);

(b) not have fraudulently included any incorrect information in the schedule mentioned in (a) above; and

(c) have reasonable cause for not meeting the requirements of sections 856(c)(2) and (3).

*Failure to meet these three conditions will terminate the election to be treated as a real estate investment trust effective for this tax year and for all succeeding tax years.*

## Part IV

Section 857(b)(6) imposes a tax equal to 100% of the net income derived from prohibited transactions. The 100% tax is imposed to prevent a real estate investment trust from retaining any profit from ordinary retailing activities such as sales to customers of condominium units or subdivided lots in a development tract.

## Line 1

### Gain from the sale or other disposition of property

Include only gains from the sale or other disposition of property described in section 1221(1) that is not foreclosure property (as defined in section 856(e)) and that does not qualify as an exception under section 857(b)(6)(C).

Do not net losses from prohibited transactions against gains in determining the amount to enter on line 1. Enter losses from prohibited transactions on the appropriate line in Part I.

## Line 2

### Deductions

Only those expenses which have a proximate and primary relationship to the earning of the income shown on line 1 may be deducted to arrive at net income from prohibited transactions. Do not deduct general overhead and administrative expenses in Part IV.

## Schedule A

### Deduction for Dividends Paid Lines 1 through 5

The rules in section 561 (taking into account sections 857(b)(8) and 858(a)) determine the deduction for dividends paid.

## Line 6

If for any tax year the real estate investment trust has net income from foreclosure property (as defined in section 857(b)(4)(B)), the deduction for dividends paid to be entered on line 6 (and on line 21b, page 1) is determined by multiplying the amount on line 5 by the following fraction:

$$\frac{\text{Real estate investment trust taxable income (determined without regard to the deduction for dividends paid)}}{\text{Real estate investment trust taxable income (determined without regard to the deduction for dividends paid) + (Net income from foreclosure property minus the tax on net income from foreclosure property)}}$$

## Schedule J

### Tax Computation

## Lines 1 and 2

**Members of a controlled group**, as defined in section 1563, whose tax years begin before July 1, 1987, are entitled to only one \$25,000 amount in each taxable income bracket on line 2a.

Members of a controlled group that have tax years that end after June 30, 1987, are entitled to only one \$50,000 amount and one \$25,000 amount (in that order) in each taxable income bracket on line 2b.

When a controlled group adopts or later amends an apportionment plan, each member must attach to its tax return a copy of its consent to this plan. The copy (or an attached statement) must show the part of the amount in each taxable income bracket apportioned to that member. There are other requirements as well. See Regulations section 1.1561-3(b) for the requirements and for the time and manner of making the consent.

**Note:** *Members of a controlled group of corporations are treated as one corporation for purposes of figuring the applicability of the additional tax imposed under section 11(b) that must be paid by corporations with taxable income in excess of a specified amount. If the additional tax applies, each member of the controlled group will pay that tax based on the portion of the amount that is used in each taxable income bracket. (See section 1561(a).) Each member of the group must attach to its tax return a schedule that shows the taxable income of the entire group as well as how its portion of the additional tax was figured.*

**Equal apportionment plan.** If no apportionment plan is adopted, the members of the controlled group must divide the amount in each taxable income bracket equally among themselves. For example, controlled group AB consists of corporation A and corporation B. They do not elect an apportionment plan. Therefore, corporation A is entitled to \$12,500 (one-half of \$25,000) in each taxable income bracket on line 2a. Corporation B is also entitled to \$12,500 in each taxable income bracket. Each income bracket on line 2b is also equally divided.

**Unequal apportionment plan.** Members of a controlled group may elect an unequal apportionment plan and divide the taxable income brackets as they wish. There is no need for consistency between taxable income brackets. Any member of the controlled group may be entitled to all, some, or none of the taxable income brackets. (But the total amount for all members of the controlled group cannot be more than the total amount in each taxable income bracket.)

### Line 3a

A real estate investment trust that files Form 1120-REIT will compute the tax on its real estate investment trust taxable income using Schedules A and B Tax Computation Worksheet, page 8. If the alternative tax does not apply (see below), enter on line 3a, Schedule J, the tax figured by the regular method from line 30 or 34 (as applicable) Schedule B, page 8.

**Alternative Tax.** If the tax year of the real estate investment trust begins before July 1, 1987, and the trust has a net capital gain on line 10, Schedule D (Form 1120), the alternative tax computation may apply. To compute the alternative tax, complete Schedules A and B Tax Computation Worksheet, page 8, as instructed and enter the amount from line 34, Schedule B, on line 12, Part IV, Schedule D (Form 1120). On line 13, Part IV, Schedule D (Form 1120), enter the product of: (1) the net capital gain from line 10, Schedule D (Form 1120), reduced by the deduction for dividends paid determined with reference to capital gain dividends only; and (2) 34%. Complete line 14, Part IV, Schedule D (Form 1120) as instructed and enter the lesser of the alternative tax or the tax figured by the regular method on line 3a, Schedule J, Form 1120-REIT.

### Line 4a

**Foreign tax credit.** See **Form 1118**, Computation of Foreign Tax Credit—Corporations, for an explanation of when a real estate investment trust can take credit for payment of income tax to a foreign country.

### Line 4b

**General business credit.** This credit is made up of the sum of the following credits:

**Investment credit.** The investment credit was generally repealed for property placed in service after 1985. See **Form 3468**, Computation of Investment Credit, for exceptions.

**Jobs credit.** The jobs credit, if elected, is allowed for hiring members of targeted groups during the tax year. See **Form 5884**, Jobs Credit, for definitions, special rules, and limitations.

Do not take an expense deduction for the part of the wages or salaries paid or incurred which is equal to the amount of the jobs credit (determined without regard to the limitation based on the tax (section 38(c))).

**Alcohol fuel credit.** A real estate investment trust may be able to take a credit for alcohol used as fuel. Use **Form 6478**, Credit for Alcohol Used as Fuel, to figure the credit.

**Credit for increasing research activities.** See **Form 6765**, Credit for Increasing Research Activities, and section 41.

**Low-income housing credit.** See **Form 8586**, Low-Income Housing Credit, and section 42.

**Form 3800, General Business Credit.** Enter the amount of the credit from Form 3800, and check the boxes indicating which forms are attached to the return. If the real estate investment trust is claiming only one of the above credits, you do not have to complete Form 3800. Instead, check the appropriate box and attach the form for which the credit is being taken. However, if the real estate investment trust has a carryforward or carryback of any of these credits (or a carryforward of an ESOP credit), it must use Form 3800.

### Line 4c

**Credit for fuel produced from a nonconventional source.** A credit is allowed for the sale of qualified fuels produced from a nonconventional source. Section 29 contains a definition of qualified fuels, provisions for figuring the credit, and other special rules. If the real estate investment trust qualifies for this credit, attach a separate schedule to the return showing the computation of the credit. Include the amount of the credit in the total for line 4c, Schedule J. Write next to the entry for line 4c the amount of the credit and identify it as "section 29 credit."

### Line 6

**Personal holding company tax.** A real estate investment trust is taxed as a personal holding company under section 542 if:

- At least 60% of its adjusted ordinary gross income, defined in section 543(b)(2), for the tax year, is personal holding company income as defined in section 543(a), and
- At any time during the last half of the tax year more than 50% in value of its outstanding stock is owned, directly or indirectly, by not more than 5 individuals.

Use **Schedule PH (Form 1120)**, Computation of U.S. Personal Holding Company Tax, to figure this tax.

### Line 7

**Tax from recomputing prior-year investment credit.** If property is disposed of or ceases to be qualified property before the end of the life-years used in computing the regular or energy investment credit, there may be a recapture of the credit. See **Form 4255**, Recapture of Investment Credit.

### Line 8a

**Alternative minimum tax.** Attach **Form 4626**, Alternative Minimum Tax—Corporations, if the total of real estate investment trust taxable income, net income from foreclosure property, and net income from prohibited transactions, plus adjustments and tax preference items of the trust exceeds \$40,000. See Form 4626 for details.

### Line 8b

**Environmental tax.** The real estate investment trust may be liable for the environmental tax if the modified alternative minimum taxable income of the real estate investment trust exceeds \$2,000,000. See Form 4626 for details.

**Caution:** At the time Form 1120-REIT and these instructions were printed, legislation was pending that would exempt real estate investment trusts from the imposition of the environmental tax.

## Instructions for Schedules A and B Tax Computation Worksheet

**Lines 1 and 19.**—If the alternative tax applies, you must modify the computation of the real estate investment trust taxable income, for purposes of these lines, by recomputing the deduction for dividends paid (line 21b, Part I, Form 1120-REIT) without taking into account capital gain dividends.

**Lines 4, 6, 8, 10, 22, and 24.**—Members of a controlled group (as defined in section 1563) must enter their portion of each taxable income bracket. See the instructions for Schedule J for rules regarding how controlled groups may divide these amounts.

**Line 17.**—If the total taxable income of the controlled group of corporations is more than \$1,000,000, each member should enter its portion of the additional tax on line 17 as explained in the instructions for Schedule J.

**Line 29.**—If the total taxable income of the controlled group of corporations is more than \$100,000, each member should enter its portion of the additional tax on line 29 as explained in the instructions for Schedule J.

**Schedules A and B Tax Computation Worksheet**

**Effective July 1, 1987, the tax rates on real estate investment trust taxable income were reduced. The new rates of tax are:**

- 15% on the first \$50,000 of income;
- 25% on the next \$25,000 of income; and
- 34% on any amount over \$75,000.

Also, an additional tax of 5% is applied against income in excess of \$100,000. The maximum amount of this additional tax is \$11,750.

***If the tax year of the real estate investment trust begins after June 30, 1987, only Schedule B must be completed.***

**Schedule A Tax Computed for Period Before July 1, 1987**

- 1 Real estate investment trust taxable income (line 22, Part I, Form 1120-REIT) (If the alternative tax applies, see instructions on page 7.)
- 2 Net capital gain (If the alternative tax applies, enter net capital gain from line 10, Schedule D (Form 1120), reduced by the deduction for dividends paid determined with reference to capital gain dividends only. Otherwise, enter zero.)
- 3 Subtract line 2 from line 1
- 4 Enter the lesser of line 3 or \$25,000 (members of a controlled group, see instructions on page 7)
- 5 Subtract line 4 from line 3
- 6 Enter the lesser of line 5 or \$25,000 (members of a controlled group, see instructions on page 7)
- 7 Subtract line 6 from line 5
- 8 Enter the lesser of line 7 or \$25,000 (members of a controlled group, see instructions on page 7)
- 9 Subtract line 8 from line 7
- 10 Enter the lesser of line 9 or \$25,000 (members of a controlled group, see instructions on page 7)
- 11 Subtract line 10 from line 9
- 12 Enter 15% of line 4
- 13 Enter 18% of line 6
- 14 Enter 30% of line 8
- 15 Enter 40% of line 10
- 16 Enter 46% of line 11
- 17 Additional tax. If line 3 is greater than \$1,000,000, enter the lesser of: (a) 5% of the excess of line 3 over \$1,000,000 or (b) \$20,250 (members of a controlled group, see instructions on page 7)
- 18 Add lines 12 through 17

**Schedule B Tax Computed for Period After June 30, 1987**

- 19 Real estate investment trust taxable income (line 22, Part I, Form 1120-REIT) (If the alternative tax applies, see instructions on page 7.)
- 20 Net capital gain (If the alternative tax applies, enter net capital gain from line 10, Schedule D (Form 1120), reduced by the deduction for dividends paid determined with reference to capital gain dividends only. Otherwise, enter zero.)
- 21 Subtract line 20 from line 19
- 22 Enter the lesser of line 21 or \$50,000 (members of a controlled group, see instructions on page 7)
- 23 Subtract line 22 from line 21
- 24 Enter the lesser of line 23 or \$25,000 (members of a controlled group, see instructions on page 7)
- 25 Subtract line 24 from line 23
- 26 Enter 15% of line 22
- 27 Enter 25% of line 24
- 28 Enter 34% of line 25
- 29 Additional tax. If line 21 is more than \$100,000, enter the lesser of: (a) 5% of the excess of line 21 over \$100,000 or (b) \$11,750 (members of a controlled group, see instructions on page 7)
- 30 Add lines 26 through 29. (If only Schedule B was completed, skip lines 31 through 34. Enter the amount from line 30 on line 3a, Schedule J, Form 1120-REIT.)
- 31 Enter amount from line 18, Schedule A, above
- 32 Line 31  $\times$   $\frac{\text{number of days in tax year before 7-1-87}}{\text{number of days in tax year}}$
- 33 Line 30  $\times$   $\frac{\text{number of days in tax year after 6-30-87}}{\text{number of days in tax year}}$
- 34 Tax on real estate investment trust taxable income. Add amounts on lines 32 and 33. If the alternative tax applies, enter on line 12, Schedule D (Form 1120). Otherwise, enter on line 3a, Schedule J, Form 1120-REIT.