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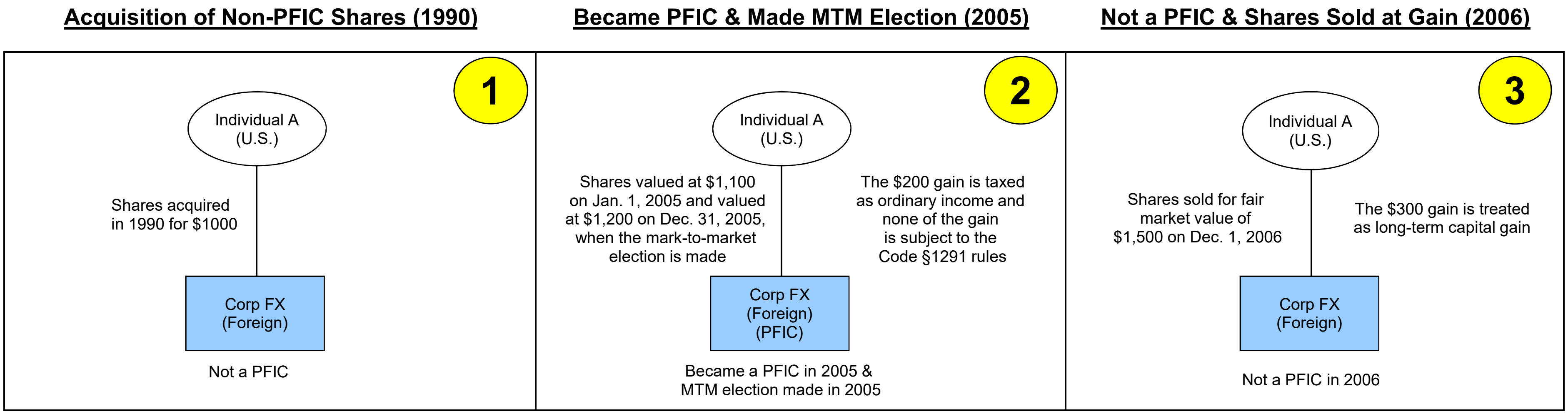
Reg. 1.1296-1(c)(7), Ex. 2

Gain Recognized in Year Ceased to be a PFIC Was Long-Term Capital Gain



A, a United States individual, purchases stock in FX, a foreign corporation that is not a PFIC, in 1990 for $1,000. On January 1, 2005, when the fair market value of the FX stock is $1,100, FX becomes a PFIC. A makes a timely Code §1296 election for taxable year 2005. On December 31, 2005, the fair market value of the FX stock is $1,200. For taxable year 2005, A includes $200 of mark to market gain (the excess of the fair market value of FX stock ($1,200) over A's adjusted basis ($1,000)) in gross income as ordinary income and pursuant to Treas. Reg. §1.1296-1(d)(1) increases his basis in the FX stock by that amount.

For taxable year 2006, FX does not satisfy either the asset test or the income test of Code §1297(a). A does not revoke the Code §1296 election it made with respect to the FX stock. On December 1, 2006, A sells the FX stock when the fair market value of the stock is $1,500. For taxable year 2006, A includes $300 of gain (the excess of the fair market value of FX stock ($1,500) over A's adjusted basis ($1,200)) in gross income as long-term capital gain because at the time of sale of the FX stock by A, FX did not qualify as a PFIC, and, therefore, the FX stock was not Code §1296 stock at the time of the disposition. Further, A's holding period for non-PFIC purposes was more than one year.