Reg. 1.1296-1(c)(7), Ex. 5

Ordinary & Capital Loss On Sale of 1296 Stock Because Loss Exceeded Unreversed Inclusions

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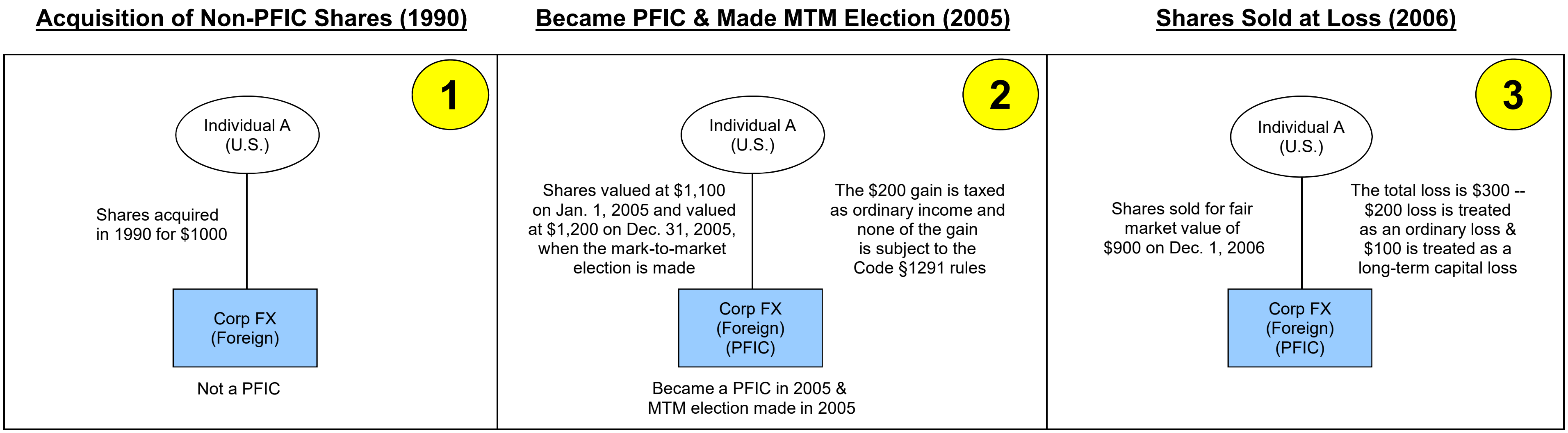

A, a United States individual, purchases stock in FX, a foreign corporation that is not a PFIC, in 1990 for $1,000. On January 1, 2005, when the fair market value of the FX stock is $1,100, FX becomes a PFIC. A makes a timely Code §1296 election for taxable year 2005. On December 31, 2005, the fair market 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.

On December 1, 2006, A sells his FX stock for $900. At the time of A's sale of the FX stock on December 1, 2006, A's unreversed inclusions with respect to the FX stock are $200. Accordingly, the $300 loss recognized by A on the disposition is treated as an ordinary loss to the extent of his unreversed inclusions ($200). The amount of the loss in excess of A's unreversed inclusions ($100) will be treated as a long-term capital loss because A's holding period in the FC stock for non-PFIC purposes was more than one year.

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