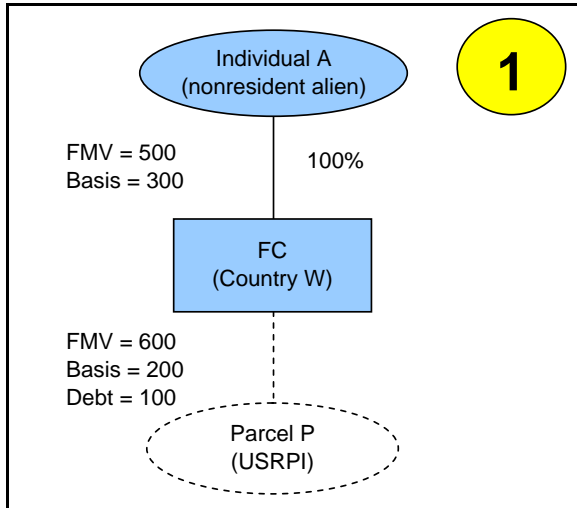


**Temp. Reg. 1.897-5T(c)(4)(iv),
Example 3**

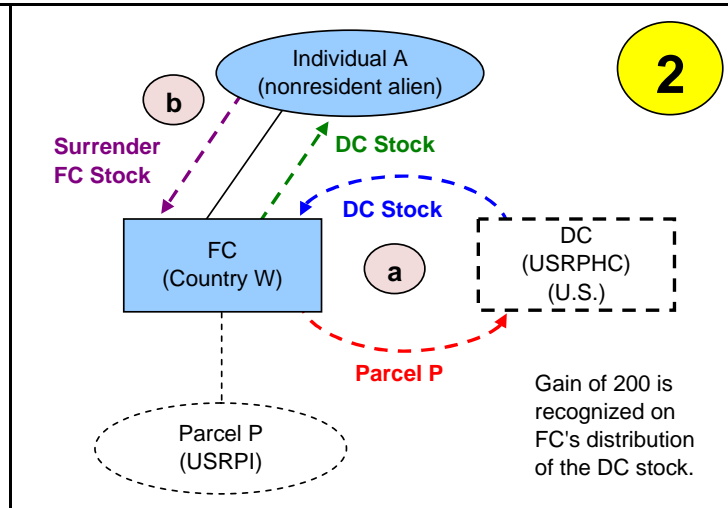
**Inbound D Reorganization:
USRPI - Regulatory Limitation**

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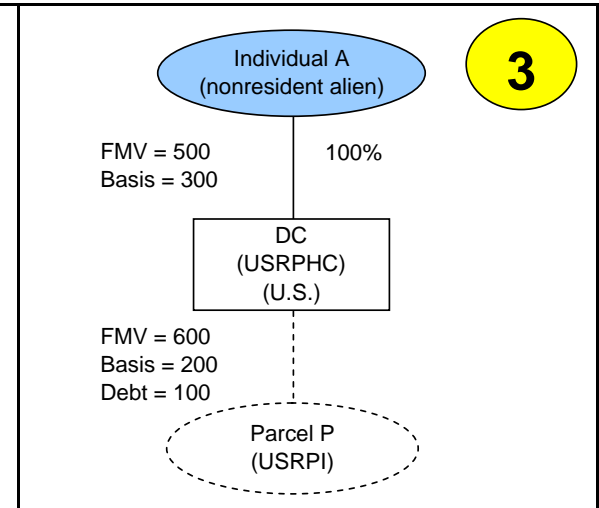
Initial Structure



Inbound D Reorganization



Ending Point



A, a nonresident alien, organized FC, a Country W corporation, in September 1980 to invest in U.S. real estate. In 1986, FC's only asset is Parcel P, a U.S. real property interest with a fair market value of \$600,000 and an adjusted basis to FC of \$200,000. Parcel P is subject to a mortgage with an outstanding balance of \$100,000. The fair market value of the FC stock is \$500,000, and A's adjusted basis in the stock is \$300,000. FC does not have liabilities in excess of the adjusted basis in Parcel P. The United States does not have a treaty with Country W that entitles FC to nondiscriminatory treatment as described in Reg. 1.897-3(b)(2).

Pursuant to a plan of reorganization under section 368(a)(1)(D), FC transfers Parcel P to DC, a newly formed domestic corporation, in exchange for DC stock. FC distributes the DC stock to A in exchange for A's FC stock. FC's exchange of Parcel P for the DC stock is a disposition of a U.S. real property interest. Under Temp. Reg. 1.897-6T(a)(1), there is an exchange of a U.S. real property interest (Parcel P) for another U.S. real property interest (DC stock) so that no gain is recognized on the exchange under section 897(e). DC takes FC's basis of \$200,000 in Parcel P under section 362(b). Under section 358(a)(1), FC takes a \$100,000 basis in the DC stock because FC's substituted basis of \$200,000 in the DC stock is reduced by the \$100,000 of liabilities to which Parcel P is subject.

Under section 897(d)(1), FC generally must recognize gain on the distribution of the DC stock received in exchange for FC's assets equal to the difference between the fair market value of the DC stock (\$500,000) and FC's adjusted basis in the DC stock prior to the distribution (\$100,000). This results in a potential gain of \$400,000. Under section 358(a)(1), A takes a basis in the DC stock equal to its basis in the FC stock of \$300,000. FC does not qualify under the statutory exception to the general recognition rule of section 897(d)(1) because A's basis in the DC stock (\$300,000) exceeds FC's adjusted basis in the DC stock (\$100,000) immediately prior to the distribution. However, provided that FC complies with the filing requirements of Temp. Reg. 1.897-5T(d)(1)(iii), the gain recognized by FC is limited to \$200,000 under the regulatory limitation. This is the excess of A's basis in the FC stock immediately before the distribution (\$300,000) over A's adjusted basis in the DC stock immediately before the distribution (\$100,000). A takes a basis of \$300,000 in the DC stock under section 358(a)(1). A's basis in the DC stock is not increased by the gain recognized by FC. DC takes a basis of \$200,000 in Parcel P under section 362(b).