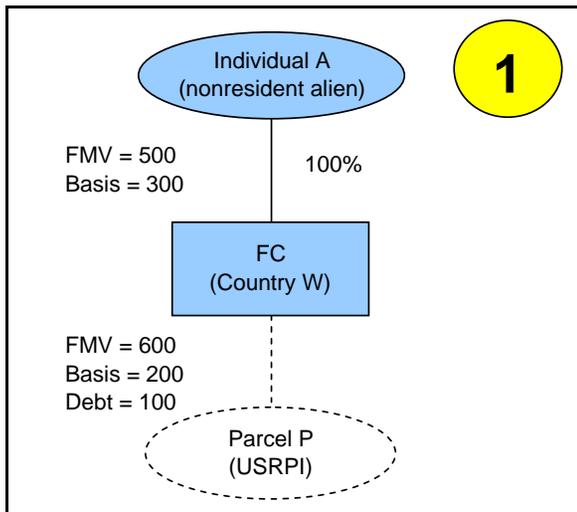


**Temp. Reg. 1.897-5T(c)(4)(iv),  
Example 4**

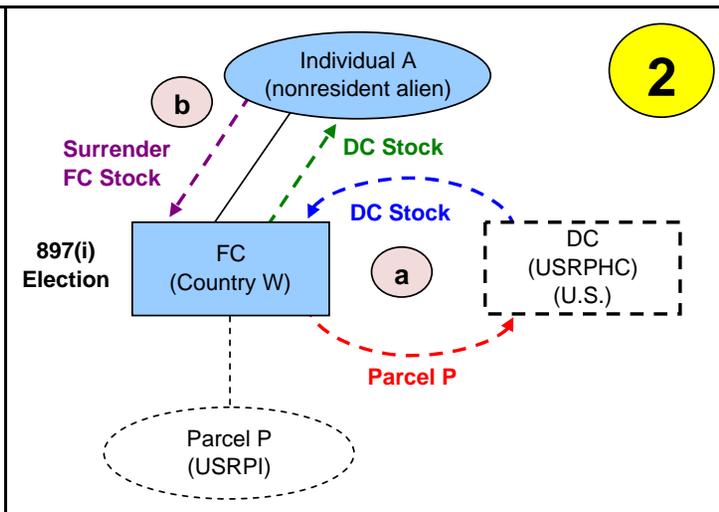
**Inbound D Reorganization:  
USRPI - 897(i) Election**

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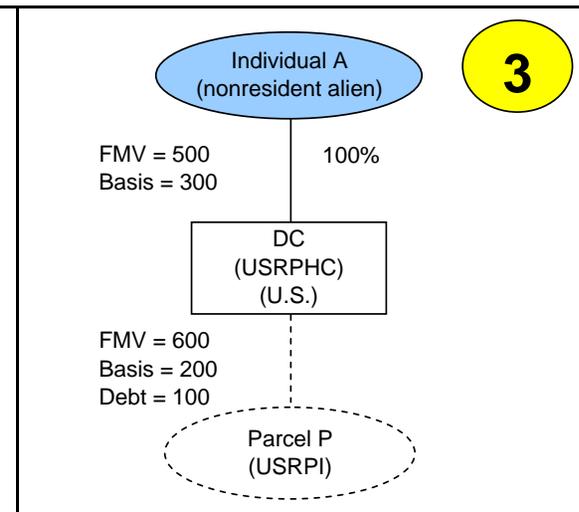
**Initial Structure**



**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).

A valid election under section 897(i) is made to treat FC as a U.S. corporation. 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. FC is treated as a domestic corporation for purposes of section 897 and is not required to recognize gain under section 897(d)(1). The FC stock in the hands of A is a U.S. real property interest because an election was made under section 897(i) to treat FC as a U.S. corporation. Under section 897(e)(1) and paragraph (a) of §1.897-6T, A does not recognize gain on the exchange because there is an exchange of a U.S. real property interest (the FC stock) for another U.S. real property interest (the DC stock). Under section 358(a)(1), A takes as its basis in the DC stock A's basis in the FC stock (\$300,000).