A is an individual citizen and resident of Country F. F has an income tax treaty with the United States that exempts gain from the sale of stock, but not real property, by a resident of F from U.S. taxation. In 1981, A transferred Parcel P, an appreciated U.S. real property interest, to DC, a U.S. real property holding corporation, in exchange for DC stock. A owned all of the stock of DC.

A must recognize gain on the transfer of Parcel P. Even though there is an exchange of a U.S. real property interest for another U.S. real property interest, there is gain recognition because the U.S. real property interest received (the DC stock) would not have been subject to U.S. taxation upon a disposition immediately following the exchange. A may not convert a U.S. real property interest that was subject to taxation under section 897 into a U.S. real property interest that could be sold without taxation under section 897 due to a treaty exemption.