

Internal Revenue Service, Treasury

§ 1.897-5T

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[T.D. 8198, 53 FR 16217, May 5, 1988]

§ 1.897-5 Corporate distributions.

(a) through (d)(1)(iii)(E) [Reserved]. For further guidance, see § 1.897-5T(a) through (d)(1)(iii)(E).

(d)(1)(iii)(F) Identification by name and address of the distributee or transferee, including the distributee's or transferee's taxpayer identification number;

(d)(1)(iii)(G) through (d)(4) [Reserved]. For further guidance, see § 1.897-5T(d)(1)(iii)(G) through (d)(4).

(e) *Effective date.* This section is applicable to transfers and distributions after November 3, 2003.

[T.D. 9082, 68 FR 46083, Aug. 5, 2003]

§ 1.897-5T Corporate distributions (temporary).

(a) *Purpose and scope.* This section provides rules concerning the recognition of gain or loss and adjustments to basis required with respect to certain corporate distributions that are subject to section 897. Paragraph (b) of this section provides rules concerning such distributions by domestic corporations, including distributions under section 301, distributions in redemption of stock, and distributions in liquidation. Paragraph (c) sets forth

rules concerning distributions by foreign corporations, including distributions under sections 301 and 355, distributions in redemption of stock, and distributions in liquidation. Finally, various rules generally applicable to distributions subject to this section, as well as to transfers subject to § 1.897-6T, are set forth in paragraph (d). The rules contained in this section are also subject to the tax avoidance rules of § 1.897-6T(c).

(b) *Distributions by domestic corporations*—(1) *Limitation of basis upon dividend distribution of U.S. real property interest.* Under section 897(f), if any domestic corporation (distributing corporation) distributes a U.S. real property interest to a shareholder that is a foreign person (distributee) in a distribution to which section 301 applies, then the basis of the distributed U.S. real property interest in the hands of the foreign distributee shall be determined in accordance with the provisions of section 301(d), and shall not exceed—

(i) The adjusted basis of the property before the distribution in the hands of the distributing corporation, increased by

(ii) The sum of—

(A) Any gain recognized by the distributing corporation on the distribution, and

(B) Any U.S. tax paid by or on behalf of the distributee with respect to the distribution.

(2) *Distributions by U.S. real property holding corporations which are taxable exchanges of stock under generally applicable rules.* If a domestic corporation, stock in which is treated as a U.S. real property interest, distributes property with respect to such stock to a foreign shareholder, the distributee shall be treated as having disposed of a U.S. real property interest, and shall recognize gain or loss on the stock of such domestic corporation to the extent that, with respect to the distributees—

(i) Part of all of the distribution is treated pursuant to section 301(c)(3)(A) as a sale or exchange of stock;

(ii) Part or all of the distribution is treated pursuant to section 302(a) as made in part or full payment in exchange for stock; or

(iii) Part or all of the distribution is treated pursuant to section 331(a) as made in full payment in exchange for stock.

Stock in a domestic corporation shall not be considered a U.S. real property interest pursuant to the provisions of § 1.897-2(f)(2) if the corporation does not hold any U.S. real property interests and has disposed of all of its U.S. real property interests owned within the previous five years in transactions in which the full amount of gain was recognized under the rules of § 1.897-2(f)(2). If gain is recognized at the corporate level on either a distribution of a U.S. real property interest or a sale of a U.S. real property interest in a liquidation, such distribution or sale shall be considered a disposition for purposes of § 1.897-2(f)(2). With regard to the consequences of a distribution from a U.S. real property holding corporation under section 355(a), see § 1.897-6T(a) (1) and (4).

(3) *Section 332 liquidations of U.S. real property holding corporations*—(i) *General rules.* Exchanges that are subject to section 897(e) are normally covered by § 1.897-6T(a) (1), (2) and (3). This paragraph (b)(3) provides rules concerning the application of section 897(e) and the general principles of § 1.897-6T(a) (1), (2) and (3) to section 332 liquidations of U.S. real property holding corporations.

(ii) *Distribution to a foreign corporation under section 332 after June 18, 1980, and before the repeal of the General Utilities doctrine.* Except for distributions under paragraph (b)(3)(iii) of this section (relating to section 332 and former section 334(b)(2)), the rules of this paragraph (b)(3)(ii) shall apply to section 332 distributions after June 18, 1980, and before January 1, 1990, pursuant to section 336(a) as in effect prior to the effective dates of the amendments made by section 631 of the Tax Reform Act of 1986. A foreign corporation that meets the stock ownership requirements of section 332(b) with respect to stock in a domestic corporation that is a U.S. real property interest shall not, after December 31, 1984, be subject to taxation by reason of section 367(a). The foreign corporation shall recognize gain pursuant to section 897(e)(1) on such stock upon the receipt of property

in a section 332(a) liquidation from such domestic corporation, but only to the extent that the property received constitutes property other than a U.S. real property interest. The gain on the stock in the domestic corporation to be recognized by the foreign corporation pursuant to section 897(e)(1) shall be determined by multiplying the gain realized on the distribution by a fraction. The numerator of the fraction shall be the fair market value of the property other than U.S. real property interests received by the foreign corporation on the distribution, and the denominator shall be the fair market value of all property received by the foreign corporation on the distribution. The bases of the distributed U.S. real property interests in the hands of the foreign corporation shall be the same as the bases in the hands of the domestic corporation. The bases of the property other than U.S. real property interests in the hands of the foreign corporation shall be the same as the bases in the hands of the domestic corporation, plus any gain recognized by the foreign corporation on the distribution allocated among such assets in proportion to the potential gain inherent in each such asset at the time of distribution. However, the basis of each asset is limited to its fair market value. Property, other than a U.S. real property interest that is distributed by the domestic corporation, shall not be considered to be distributed by the domestic corporation pursuant to a section 332 liquidation (that is, the foreign corporation shall not be considered to be a corporation for purposes of section 332) if the requirements of section 367(a) are not satisfied. See, for example, sections 1245(b)(3) and 1250(d)(3) regarding the consequences to the distributing domestic corporation if the requirements of section 367(a) are not satisfied.

(iii) *Distribution to a foreign corporation under section 332 and former section 334(b)(2) after June 18, 1980.* The rules of this paragraph (b)(2)(iii) shall apply to section 332 distributions after June 18, 1980 where the basis of the distributed property in the hands of the foreign corporation is determined under section 334(b)(2) as in effect prior to the Tax Equity and Fiscal Responsibility Act of 1982. A foreign corporation that

meets the stock ownership requirements of section 332(b) with respect to stock in a domestic corporation that is a U.S. real property interest shall recognize gain on the receipt of property in a section 332(a) liquidation where section 334(b)(2) applies to the extent that the fair market value of the distributed assets that are not U.S. real property interests exceeds the basis of such assets determined under section 334(b)(2) (for example, if the liquidation does not occur immediately upon the purchase of stock in the domestic corporation). The gain recognized shall not exceed the excess of the fair market value of the stock of the domestic corporation in the hands of the foreign corporation at the time of the distribution over the shareholder's adjusted basis in such stock. The basis of the distributed U.S. real property interests in the hands of the foreign corporation shall be determined under section 334(b)(2), by reference to the adjusted basis of the stock with respect to which the distribution was made. The basis of such property other than U.S. real property interests shall be tentatively determined under section 334(b)(2), and then increased by any gain recognized by the foreign corporation on the distribution allocated among such assets in proportion to the potential gain inherent in each such asset at the time of distribution (computed using the tentative basis as determined under section 334(b)(2)). The basis of each asset is limited, however, to its fair market value.

(iv) *Distribution to a foreign corporation under section 332 after July 31, 1986 and after the repeal of the General Utilities doctrine.* The rules of this subdivision (iv) shall apply to section 332 distributions after July 31, 1986, pursuant to section 337(a) as in effect after the effective dates of the amendments of section 631 of the Tax Reform Act of 1986.

(A) *Liquidation of domestic corporation.* A foreign corporation that meets the stock ownership requirements of section 332(b) with respect to stock in a domestic corporation that is a U.S. real property interest (except a foreign corporation that has made an effective election under section 897(i) and the stock of which is treated as a U.S. real

property interest) shall not recognize any gain under sections 367(a) or 897(e)(1) on the receipt of property in a section 332(a) liquidation. The domestic corporation shall not recognize gain under section 367(e)(2) on the distribution of U.S. real property interests (other than stock in a former U.S. real property holding corporation which is treated as a U.S. real property interest) to the foreign corporation. The domestic corporation shall recognize gain under section 367(e)(2) on the distribution of stock in a former U.S. real property holding corporation which is treated as a U.S. real property interest. With respect to the recognition of gain or loss by the domestic corporation under section 367(e)(2) on the distribution of property other than U.S. real property interests, see the regulations under section 367(e)(2). The basis of the distributed U.S. real property interests (other than stock in a former U.S. real property holding corporation) in the hands of the foreign corporation shall be the same as it was in the hands of the domestic corporation. The basis of any property (other than U.S. real property interests) and stock in a former U.S. real property holding corporation that is a U.S. real property interest in the hands of the foreign corporation shall be the same as it was in the hands of the domestic corporation increased by any gain recognized by the distributing corporation on the distribution that was subject to U.S. taxation.

(B) *Liquidation of certain foreign corporations making a section 897(i) election.* A foreign corporation that meets the stock ownership requirements of section 332(b) with respect to stock in another foreign corporation, that has made an effective election under section 897(i) and the stock of which is treated as a U.S. real property interest, shall recognize gain pursuant to section 897(e)(1) on such stock upon the receipt from the distributing foreign corporation of property that is not a U.S. real property interest, and that is not used by the distributee foreign corporation in the conduct of a trade or business within the United States (if the distributee foreign corporation is not a resident of a country with which the United States maintains an income tax

treaty) or in a permanent establishment within the United States (if the distributee foreign corporation is a resident of a country with which the United States maintains an income tax treaty). The gain on the stock in the foreign corporation (making an effective election under section 897(i)) to be recognized by the distributee foreign corporation pursuant to section 897(e)(1) shall be determined by multiplying the gain realized on the distribution by a fraction. The numerator of the fraction shall be the fair market value of the property received by the distributee foreign corporation upon which it must recognize gain, and the denominator of the fraction shall be the fair market value of all property received by the distributee foreign corporation on the distribution. The distributing foreign corporation shall not recognize gain under section 367(e)(2) on the distribution of U.S. real property interests to the distributee foreign corporation. With respect to the recognition of gain or loss under section 367(e)(2) on the distribution of property other than U.S. real property interests, see the regulations under section 367(e)(2). The basis of the distributed U.S. real property interests in the hands of the distributee foreign corporation shall be the same as it was in the hands of the distributing foreign corporation. The basis of the property upon which the distributee foreign corporation recognized gain in the hands of the distributee foreign corporation shall be the same as the basis in the hands of the distributing foreign corporation, plus any gain recognized by the distributee foreign corporation on the receipt of such property allocated among such property in proportion to the potential gain inherent in each such property at the time of the distribution. In regard to the basis of any other property received by the distributee foreign corporation in the liquidation, see the regulations under section 367(e)(2). However, the basis of each asset is limited to its fair market value.

(v) *Transfer of foreign corporation stock followed by a section 332 liquidation treated as a reorganization.* If a nonresident alien or foreign corporation transfers the stock of a foreign-corporation that

owns a U.S. real property interest to a domestic corporation in exchange for stock of the domestic corporation (or its domestic or foreign parent corporation) in a reorganization under section 368(a)(1)(B) or in an exchange under section 351(a), and if the foreign corporation then distributes the U.S. real property interest to the domestic corporation in a liquidation described in section 332(a) within five years of the transfer of the stock of the foreign corporation to the domestic corporation, then the transfer of the foreign corporation stock and the liquidation shall be treated as a reorganization described in section 368(a)(1) (C) or (D). The rules of § 1.897-6T(a)(1) shall apply to the transfer of the U.S. real property interest to the domestic corporation in exchange for domestic corporation stock, and the rules of § 1.897-5T(c)(4) shall apply to the distribution of domestic corporation stock by the foreign corporation. However, the rules of this paragraph (b)(3)(v) shall not apply if the transfer of the foreign corporation stock and the liquidation under section 332(a) are separate and independent transactions justified by substantial and verifiable business purposes.

(4) *Section 897(i) companies.* Except as otherwise provided herein for purposes of this section and § 1.897-6T, a foreign corporation that has made a valid election under section 897(i) shall be treated as a domestic corporation and not as a foreign corporation in determining the application of section 897. For rules concerning the making of a section 897(i) election, see §§ 1.897-3 and 1.897-8T. In regard to section 367(e)(2) and foreign corporations that have made an effective election under section 897(i), see paragraph (b)(3)(iv) of this section.

(5) *Examples.* The following examples illustrate the rules of this paragraph (b). In each example there is no applicable income tax treaty to which the United States is a party.

Example 1. (i) A is a nonresident alien who owns 100 percent of the stock of DC, a U.S. real property holding corporation. DC's only asset is Parcel P, a U.S. real property interest, with a fair market value of \$500,000 and an adjusted basis of \$300,000. DC completely liquidates in 1987 and distributes Parcel P to A in exchange for the DC stock held by A.

(ii) Under section 336(a), DC must recognize gain to the extent of the excess of the fair market value (\$500,000) over the adjusted basis (\$300,000), or \$200,000.

(iii) A does not recognize any gain under section 897(a) because the DC stock in the hands of A is no longer a U.S. real property interest under paragraph (b)(2) of this section and paragraph 2(f) of § 1.897-2. A does recognize gain (if any) under section 331(a); however, the gain is not subject to taxation under section 871(a). A's adjusted basis in Parcel P is \$500,000.

(iv) If DC did not recognize all of the gain on the disposition under a transitional rule to section 631 of the Tax Reform Act of 1986, then paragraph (b)(2) of this section and paragraph 2(f) of § 1.897-2 would not apply to A. A would recognize gain (if any) under paragraph (b)(2) because the distribution is treated as in full payment in exchange for the DC stock under section 897(a).

Example 2. (i) FC, a Country F corporation, owns 100 percent of the stock of DC, a U.S. real property holding corporation. FC's basis in the stock of DC is \$400,000, and the fair market value of the DC stock is \$800,000. DC owns a U.S. real property interest with an adjusted basis of \$350,000 and a fair market value of \$600,000. DC also owns other assets that are not U.S. real property interests that have an adjusted basis of \$125,000 and a fair market value of \$200,000. DC completely liquidates in 1985 and distributes all of its property to FC in exchange for the DC stock held by FC.

(ii) Under paragraph (b)(3)(ii) of this section, FC recognizes \$100,000 of gain under section 897(a) on the disposition of the DC stock. This is determined by multiplying FC's gain realized (\$400,000) by a fraction. The numerator of the fraction is the fair market value of the property other than U.S. real property interests (\$200,000), and the denominator of the fraction is the fair market value of all property received (\$800,000). FC takes a carryover adjusted basis in the U.S. real property interest (\$350,000). FC's adjusted basis in the assets that are not U.S. real property interests (\$200,000) is the basis of those assets in the hands of DC (\$125,000) plus the gain recognized by FC on the distribution (\$100,000) not to exceed the fair market value (\$200,000).

Example 3. (i) FC, a Country F corporation, owns 100 percent of the stock of DC, a U.S. real property holding corporation. FC's basis in the stock of DC is \$300,000, and the fair market value of the DC stock is \$500,000. DC owns Parcel P, a U.S. real property interest, with an adjusted basis of \$250,000 and a fair market value of \$400,000. DC also owns all of the stock of DX, a former U.S. real property holding corporation whose stock is a U.S. real property interest, with an adjusted basis of \$50,000 and a fair market value of \$100,000.

DC completely liquidates in 1987 and distributes all of its property to FC in exchange for the DC stock held by FC.

(ii) Under paragraph (b)(3)(iv)(A) of this section, DC recognizes \$50,000 of gain on the distribution to FC of the DX stock. DC does not recognize any gain for purposes of section 367(e)(2) on the distribution to FC of Parcel P.

(iii) Under paragraph (b)(3)(iv)(A) of this section, FC's disposition of its DC stock is not treated as a disposition of a U.S. real property interest. Under section 334(b)(1), FC takes a carryover adjusted basis of \$250,000 in Parcel P. FC takes an increased basis of \$100,000 in the DX stock which is equal to DC's basis (\$50,000) increased by the gain recognized by DC (\$50,000).

(iv) The result would be the same if FC had made an effective election under section 897(i).

(6) *Section 333 elections*—(i) *General rule.* A foreign shareholder that elects section 333 as in effect prior to its repeal by the Tax Reform Act of 1986 upon the distribution of property in a liquidation by a domestic corporation whose stock is treated as a U.S. real property interest shall recognize gain on such stock to the extent that—

(A) The property received by the foreign shareholder constitutes property other than U.S. real property interests subject to U.S. taxation upon its disposition as specified by paragraph (a)(1) of this section, or

(B) The basis of a U.S. real property interest subject to U.S. taxation upon its disposition in the hands of the recipient foreign shareholder exceeds the basis of the U.S. real property interest in the hands of the liquidating domestic corporation.

In determining the amount of gain recognized by the foreign shareholder, the foreign shareholder shall be considered to have exchanged the domestic corporation stock for all the property distributed on a proportionate fair market value basis. The gain recognized on a respective portion of domestic corporation stock shall not exceed the gain realized on that portion. Property other than U.S. real property interests subject to U.S. taxation upon disposition shall have a fair market value basis in the hands of the foreign shareholder. The basis of U.S. real property interests subject to U.S. taxation upon disposition shall be the basis of the proportionate part of the domestic cor-

poration stock cancelled or redeemed in the liquidation, increased in the amount of gain recognized (other than gain recognized under this section) by the shareholder in respect to that proportionate part of the domestic corporation stock.

(ii) *Example.* The rules of paragraph (b)(6)(i) of this section may be illustrated by the following example.

Example. (i) A is a citizen and resident of Country F with which the U.S. does not have an income tax treaty. A owns all of the stock of DC, a U.S. real property holding corporation. The DC stock has a fair market value of \$1,000,000. A acquired the DC stock in two purchases. The basis of one lot of the DC stock is \$150,000, and the basis of the other lot is \$650,000.

(ii) DC owns Parcel P, a U.S. real property interest, with a fair market value of \$750,000 and an adjusted basis of \$400,000. DC's only other property is equipment with a fair market value of \$250,000 and an adjusted basis of \$100,000. DC does not have any earnings and profits.

(iii) DC completely liquidates in 1985 in accordance with section 333 by distributing Parcel P and the equipment to A. A elects section 333 treatment.

(iv) A is considered as having exchanged 75 percent (fair market value of Parcel P/fair market value of all property distributed) of the DC stock for Parcel P. A realized gain of \$150,000 on that portion of the DC stock (\$750,000-\$600,000). All of the gain of \$150,000 is recognized under section 897 (a) because A's basis in Parcel P under section 334 (c) (\$600,000) would exceed DC's basis in Parcel P (\$400,000) by at least the amount of realized gain. A takes a basis of \$750,000 in Parcel P.

(v) A is considered as having exchanged 25 percent (fair market value of equipment/fair market value of all property distributed) of the DC stock for the equipment. A realized gain of \$50,000 on that portion of the DC stock (\$250,000-\$200,000). All of the gain of \$50,000 is recognized under section 897 (a). A takes a basis of \$250,000 in the equipment.

(c) *Distributions of U.S. real property interests by foreign corporations*—(1) *Recognition of gain required.* If a foreign corporation makes a distribution (including a distribution in liquidation or redemption) of a U.S. real property interest to a shareholder (whether foreign or domestic), then, except as provided in paragraph (c) (2), (3), or (4) of this section, the distributing corporation shall recognize gain (but not loss) on the distribution under section 897 (d) (1). The gain recognized shall be equal to the excess of the fair market

value of the U.S. real property interest (as of the time of the distribution) over its adjusted basis. Except as otherwise provided, the distributee's basis in the distributed U.S. real property interest shall be determined under the otherwise applicable sections of the Code. The distributee (whether domestic or foreign) of a foreign corporation in a liquidation under section 332 shall take the foreign corporation's basis in the distributed U.S. real property interest increased by any gain recognized (and subject to U.S. income taxation) by the foreign corporation on the distribution of such U.S. real property interest.

(2) *Recognition of gain not required*—(i) *Statutory exception rule.* Under section 897(d)(2)(A), gain shall not be recognized by a distributing foreign corporation if—

(A) At the time of the receipt of the distributed U.S. real property interest, the distributee would be subject to U.S. income taxation on a subsequent disposition of the U.S. real property interest, determined in accordance with the rules of paragraph (d)(1) of this section;

(B) The basis of the distributed U.S. real property interest in the hands of the distributee is no greater than the adjusted basis of such property before the distribution, increased by the amount of gain (if any) recognized by the distributing corporation upon the distribution and added to the adjusted basis under the otherwise applicable provisions; and

(C) The distributing corporation complies with the filing requirements of paragraph (d)(1)(iii) of this section.

(ii) *Section 332 liquidations*—(A) *In general.* A distributing foreign corporation that meets the requirements of paragraph (c)(2)(i) in a section 332(a) liquidation shall not recognize gain on the distribution of U.S. real property interests to a foreign corporation meeting the stock ownership requirements of section 332(b) if the distributing corporation complies with the procedural requirements of paragraph (d)(1)(iii). Whether a foreign corporation recognizes gain on the distribution of U.S. real property interests to a U.S. corporation meeting the stock ownership requirements of section 332(b) depends upon whether the U.S. corporation satisfies the subject to tax re-

quirement provided in paragraph (d)(1)(i) (in addition to the procedural requirements of paragraph (d)(1)(iii)). With respect to section 332 distributions by a foreign corporation occurring after July 31, 1986, section 367(e)(2) shall not affect the application of section 337(a) (as in effect after the Tax Reform Act of 1986) and paragraph (c)(2)(i) of this section to the distribution of a U.S. real property interest.

(B) *Recognition of gain required in certain section 332 liquidations.* Notwithstanding the other rules of this paragraph (c), a foreign corporation shall, pursuant to the authority conferred by section 897(e)(2), recognize gain on its distribution after May 5, 1988 of a U.S. real property interest to a domestic corporation meeting the stock ownership requirements of section 332(b) if—

(1) The foreign corporation has not made an election under section 897(i), and any gain on the stock in the foreign corporation would be subject to U.S. taxation if an election were made on the date of the liquidation; and

(2) The distribution of the U.S. real property interest by the foreign corporation to the domestic corporation pursuant to section 332(a) occurs less than five years after the date of the last gain from the disposition of stock of the foreign corporation that would be subject to payment of tax under § 1.897-3(d)(2)(i) if an election under section 897(i) were made by the foreign corporation on the date of its liquidation.

With regard to the treatment of certain foreign corporations as domestic corporations under section 897(i), however, see §§ 1.897-3 and 1.897-8T.

(iii) *Examples.* The rules of this paragraph (c)(2) may be illustrated by the following examples.

Example 1. (i) DC, a domestic corporation, owns 100 percent of the stock of FC, a Country F corporation. FC's only asset is Parcel P, a U.S. real property interest, with a fair market value of \$500x and an adjusted basis of \$100x. In September 1987, FC liquidates under section 332(a) and transfers Parcel P to DC. The transitional rules contained in section 633 of the Tax Reform Act of 1986 concerning the repeal of the *General Utilities* doctrine would not be applicable to a subsequent distribution or disposition of assets by DC.

(ii) Assume that FC complies with the filing requirements of paragraph (d)(1)(iii). DC

will be subject to U.S. income taxation on a subsequent disposition of Parcel P under the rules of paragraph (d)(1). The basis of Parcel P in the hands of DC will be \$100x under section 334(b)(1), and thus no greater than the basis of Parcel P in the hands of FC. FC does not recognize any gain under the rules of paragraph (c)(1) of this section on the distribution because the exception of paragraph (d)(2)(i) applies.

Example 2. If in *Example (1)* the distribution by FC to DC occurred in September 1985, and DC sold or exchanged Parcel P under sections 336(a) or 337(a) as in effect prior to the Tax Reform Act of 1986, then FC must recognize gain of \$400x on the distribution of Parcel P. The gain must be recognized because Parcel P in the hands of DC is not considered subject to U.S. income taxation on a subsequent disposition under the rules of paragraph (d)(1) of this section.

(3) *Limitation of gain recognized under paragraph (c)(1) of this section for certain section 355 distributions—(i) In general.* Under paragraph (c)(1) of this section, a foreign corporation that distributes stock in a domestic corporation that constitutes a U.S. real property interest in a distribution to which section 355 applies shall recognize gain on the distribution to the extent that the fair market value of the distributed stock exceeds its adjusted basis in the hands of the distributing foreign corporation. The gain recognized shall be limited under this paragraph (c)(3), however, to the amount by which the aggregate basis of the distributed stock in the hands of the distributees exceeds the aggregate adjusted basis of the distributed stock in the hands of the distributing corporation. The distributees' basis in the distributed U.S. real property interest shall be determined under the otherwise applicable provisions of section 358. (Thus, the distributees' basis in the distributed U.S. real property interest shall be determined without any increase for any gain recognized by the foreign corporation).

(ii) *Example.* The rules of paragraph (c)(3)(i) of this section may be illustrated by the following example.

Example. (i) C is a citizen and resident of Country F. C owns all of the stock of FC, a Country F corporation. The fair market value of the FC stock is 1000x, and C has a basis of 600x in the FC stock. Country F does not have an income tax treaty with the United States.

(ii) In a transaction qualifying as a distribution of stock of a controlled corporation

under section 355(a), FC distributes to C all of the stock of DC, a U.S. real property holding corporation. C does not surrender any of the FC stock. The DC stock has a fair market value of 600x, and FC has an adjusted basis of 200x in the DC stock. After the distribution, the FC stock has a fair market value of 400x.

(iii) Under paragraph (c)(3)(i) of this section, FC must recognize gain on the distribution of the DC stock to C equal to the difference between the fair market value of the DC stock (600x) and FC's adjusted basis in the DC stock (200x). This results in a potential gain of 400x. Under section 358, C takes a 360x adjusted basis in the DC stock. Provided that FC complies with the filing requirements of paragraph (d)(1)(iii) of this section, the gain recognized by FC is limited under paragraph (c)(3)(i) to 160x because (A) this is the amount by which the basis of the DC stock in the hands of C (360x) exceeds the adjusted basis of the DC stock in the hands of FC (200x), and (B) at the time of receipt of the DC stock, C would be subject to U.S. taxation on a subsequent disposition of the stock.

(iv) C's adjusted basis in the DC stock is not increased by the 160x recognized by FC.

(4) *Distribution by a foreign corporation in certain reorganizations—(i) In general.* Under paragraph (c)(1) of this section, a foreign corporation that transfers property to another corporation in an exchange under section 361(a) for stock of a domestic corporation which is a United States real property holding corporation immediately after the transfer in a reorganization under section 368(a)(1) (C), (D), or (F) shall recognize gain under section 897(d)(1) on the distribution (whether actual or deemed) of the stock of the domestic corporation received by the foreign corporation to its shareholders (whether domestic or foreign). See §1.897-6T(a) of the regulations for the consequences to the foreign corporation of the exchange of its property for the domestic corporation stock.

(ii) *Statutory exception.* Pursuant to the exception provided in section 897(d)(2)(A), no gain shall be recognized by the foreign corporation on its distribution of the domestic corporation stock if—

(A) At the time of the distribution, the distributee (*i.e.*, the exchanging shareholder in the section 354 exchange) would be subject to U.S. taxation on a subsequent disposition of the stock of the domestic corporation,

determined in accordance with the rules of paragraph (d)(1) of this section;

(B) The distributee's adjusted basis in the stock of the foreign corporation immediately before the distribution was no greater than the foreign corporation's basis in the stock of the domestic corporation determined under section 358; and

(C) The distributing corporation complies with the filing requirements of paragraph (d)(1)(iii) of this section.

(iii) *Regulatory limitation on gain recognized.* If the requirements of subdivisions (A) and (C) of paragraph (c)(4)(ii) are met, the amount of any gain recognized by the foreign corporation shall not exceed the excess of the distributee's adjusted basis in the stock of the foreign corporation immediately before the distribution over the foreign corporation's basis in the stock of the domestic corporation immediately before the distribution as determined under section 358.

(iv) *Examples.* The rules of paragraph (c)(4) of this section may be illustrated by the following examples.

Example 1. (i) 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 \$100,000. 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 section 1.897-3(b)(2) of the regulations.

(ii) 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.

(iii) FC's exchange of Parcel P for the DC stock is a disposition of a U.S. real property interest. Under § 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.

(iv) Under section 897(d)(1) and paragraph (c)(4)(i) of this section, 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 \$100,000. Provided that FC complies with the filing requirements of paragraph (d)(1)(iii) of this section, no gain is recognized by FC on the distribution of the DC stock under the statutory exception to the general rule of section 897(d)(1) provided in section 897(d)(2)(A) and paragraph (c)(4)(ii) of this section because (1) A's basis in the DC stock (\$100,000) does not exceed FC's adjusted basis in the DC stock (\$100,000) immediately prior to the distribution and (2) A, at the time of receipt of the DC stock, would be subject to U.S. taxation on a subsequent disposition of the stock.

(v) The FC stock in the hands of A is not a U.S. real property interest because FC is a foreign corporation that has not elected to be treated as a domestic corporation under section 897(i). Accordingly, the exchange of the FC stock by A for DC stock is not a disposition of a U.S. real property interest under section 897(a).

Example 2. The facts are the same as in Example 1, except that A purchased the FC stock in September 1983 for \$100,000 from S, a nonresident alien, and that S had a basis of \$40,000 in the FC stock at the time of the sale to A. The results are the same as in Example 1.

Example 3. (i) The facts are the same as in Example 1, except that A's adjusted basis in the FC stock prior to the reorganization is \$300,000. Following the distribution, A takes its basis of \$300,000 in the FC stock as its basis in the DC stock pursuant to section 358(a)(1).

(ii) FC does not qualify under the statutory exception of paragraph (c)(4)(ii) to the general recognition rule of section 897(d)(1) and paragraph (c)(4)(i) of this section 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 paragraph (d)(1)(iii) of this section, the gain recognized by FC is limited to \$200,000 under the regulatory limitation of gain provided by paragraph (c)(4)(iii). 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).

(iii) 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).

Example 4. (i) The facts are the same as in *Example 3*, except that the United States has an income tax treaty with Country W entitling FC to nondiscriminatory treatment under section 1.897-3(b)(2) of the regulations. A valid election under section 897(i) is made to treat FC as a U.S. corporation.

(ii) FC is treated as a domestic corporation for purposes of section 897 and is not required to recognize gain under section 897(d)(1) and paragraph (c)(4)(i) of this section on the distribution of the DC stock as described in *Example 3*. (If a valid section 897(i) election were not made, the result would be same as in *Example 3*.)

(iii) 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. The exchange of the FC stock for DC stock by A is a disposition of a U.S. real property interest. 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).

(5) *Sales of U.S. real property interests by foreign corporations under section 337.* Section 337 as in effect prior to the Tax Reform Act of 1986 shall not apply to any sale or exchange (including a deemed section 337 sale pursuant to an election under section 338(a) to treat a stock purchase as an asset acquisition) of a U.S. real property interest by a foreign corporation.

(6) *Section 897(l) credit.* If a foreign corporation adopts a plan of complete liquidation and if, solely by reason of section 897(d) and this section, section 337(a) (as in effect before the Tax Reform Act of 1986) does not apply to sales or exchanges of, or section 336 (as in effect before the Tax Reform Act of 1986) does not apply to distributions of, United States real property interests by the liquidating corporation, then—

(i) The amount realized by the shareholder on the distribution shall be increased by its proportionate share of the amount by which the tax imposed by chapter 1 of the Code, as modified by the provisions of any applicable U.S. income tax treaty, on the liquidating corporation would have been reduced if

section 897(d) and this section had not been applicable, and

(ii) For purposes of the Code, the shareholder shall be deemed to have paid, on the last day prescribed by law for the payment of the tax imposed by subtitle A of the Code on the shareholder for the taxable year, an amount of tax equal to the amount of increase in the amount realized described in subdivision (i) of this paragraph (c).

The special rule provided by this paragraph (c)(5) applies only to shareholders who are United States citizens or residents, and who have held stock in the liquidating corporation continuously since June 18, 1980. This special rule also only applies for the first taxable year of any such shareholder in which the shareholder receives a distribution in complete liquidation from the foreign corporation.

(7) *Other applicable rules.* For rules concerning exemption of gain pursuant to a U.S. income tax treaty, withholding of tax from distributions, and other applicable rules, see paragraph (d) of this section. For the treatment of liquidations described in section 334(b)(2)(A) of certain foreign corporations acquired before November 6, 1980, see § 1.897-4.

(d) *Rules of general application—(1) Interests subject to taxation upon later disposition—(i) In general.* Pursuant to the otherwise applicable rules of this section and § 1.897-6T, nonrecognition of gain or loss may apply with respect to certain distribution or exchanges of U.S. real property interests if any gain from a subsequent disposition of the interests that are distributed or received by the transferor in the exchange would be included in the gross income of the distributee or transferor and be subject to U.S. taxation. Gain is considered subject to U.S. taxation if the gain is included on the income tax return of a U.S. tax paying entity even if there is no U.S. tax liability (for example, because of net operating losses or an investment tax credit). Gain is not considered subject to U.S. taxation if the gain is derived by a tax exempt entity. A real estate investment trust is considered to be a pass-through entity for purposes of the rule of taxability of

this paragraph (d)(1)(i). Thus, for example, a tax exempt entity holding an interest in a real estate investment trust is not subject to tax. A domestic corporation (including a foreign corporation that makes an effective section 897(i) election after receipt of the U.S. real property interest) shall not be considered subject to U.S. taxation on a subsequent disposition of a U.S. real property interest if it received the U.S. real property interest prior to the effective date of the repeal of section 336(a) or 337(a) as in effect prior to the Tax Reform Act of 1986, unless the U.S. real property interest has not been sold or exchanged by the domestic corporation prior to such effective date in a transaction to which either section 336(a) or section 337(a) (as in effect prior to such effective date) applied. In addition, an interest shall be considered to be subject to U.S. taxation upon its subsequent disposition only if the requirements set forth in subdivision (iii) of this paragraph (d)(1) are met.

(ii) *Effects of income tax treaties—(A) Effect of treaty exemption from tax.* Except as otherwise provided in subdivision (C) of this paragraph (d)(1)(ii), a U.S. real property interest shall not be considered to be subject to U.S. taxation upon a subsequent disposition if, at the time of its distribution or exchange, the recipient is entitled pursuant to the provisions of a U.S. income tax treaty to an exemption from U.S. taxation upon a disposition of the interest.

(B) *Effect of treaty reduction of tax.* If, at the time of a distribution or exchange, a distributee of a U.S. real property interest in a distribution or a transferor who receives a U.S. real property interest in an exchange would be entitled pursuant to the provisions of a U.S. income tax treaty to reduced U.S. taxation upon the disposition of the interest, then a portion of the interest received shall be treated as an interest subject to U.S. taxation upon its disposition, and, therefore, that portion shall be entitled to nonrecognition treatment under the rules of this section or § 1.897-6T. The portion of the interest that is treated as subject to U.S. taxation is determined by multiplying the fair market value of the in-

terest by a fraction. The numerator of the fraction is the amount of tax that would be due pursuant to the provisions of the applicable U.S. income tax treaty upon the recipient's disposition of the interest, determined as of the date of the distribution or transfer. The denominator of the fraction is the amount of tax that would be due upon such disposition but for the provisions of the treaty. However, nonrecognition treatment may be preserved in accordance with the provisions of subdivision (C) of this paragraph (d)(1)(ii). With regard to the provisions of this paragraph, see Article XIII (9) of the United States-Canada Income Tax Convention.

(C) *Waiver of treaty benefits to preserve nonrecognition.* Notwithstanding the provisions of subdivisions (A) and (B) of this paragraph (d)(1)(ii), an interest shall be considered to be subject to U.S. taxation upon its subsequent disposition if, in accordance with paragraph (d)(1)(iii)(F) of this section, the recipient waives the benefits of a U.S. income tax treaty that would otherwise entitle the recipient to an exemption from (or reduction of) U.S. tax upon a disposition of the interest.

(iii) *Procedural requirements.* If a U.S. real property interest is distributed or transferred after December 31, 1987, the transferor or distributor (that is a non-resident alien individual or a foreign corporation) shall file an income tax return for the taxable year of the distribution or transfer. Also, if a U.S. real property interest is distributed or transferred in a transaction before January 1, 1988, with respect to which nonrecognition treatment would not have been available under the express provisions of section 897 (d) or (e) of the Code but is available under the provisions of this section or § 1.897-6T, then the person that would otherwise be subject to tax by reason of the operation of section 897 must file an income tax return for the taxable year of the distribution or transfer. This requirement is satisfied by filing a tax return or an amended tax return for the year of the distribution or transfer by May 5, 1989, or by the date that the filing of the return is otherwise required. The person filing the return must attach thereto a document setting forth the following:

(A) A statement that the distribution or transfer is one to which section 897 applies;

(B) A description of the U.S. real property interest distributed or transferred, including its location, its adjusted basis in the hands of the distributor or transferor immediately before the distribution or transfer, and the date of the distribution or transfer;

(C) A description of the U.S. real property interest received in an exchange;

(D) A declaration signed by an officer of the corporation that the distributing foreign corporation has substantiated the adjusted basis of the shareholder in its stock if the distributing corporation has nonrecognition or recognition limitation under paragraph (c) (3) or (4) of this section;

(E) The amount of any gain recognized and tax withheld by any person with respect to the distribution or transfer;

(F) [Reserved]. For further guidance, see § 1.897-5(d)(1)(iii)(F).

(G) The treaty and article (if any) under which the distributee or transferor would be exempt from U.S. taxation on a sale of the distributed U.S. real property interest or the U.S. real property interest received in the transfer; and

(H) A declaration, signed by the distributee or transferor or its authorized legal representative, that the distributee or transferor shall treat any subsequent sale, exchange, or other disposition of the U.S. real property interest as a disposition that is subject to U.S. taxation, notwithstanding the provisions of any U.S. income tax treaty or intervening change in circumstances.

A person who has provided or filed a notice described in § 1.1445-2(d)(2)(iii) or § 1.1445-5(b)(2)(ii) in connection with a transaction may satisfy the requirement of this paragraph (d)(1)(iii) by attaching to his return a copy of that notice together with any information or declaration required by this subdivision not contained in that notice.

(2) *Treaty exception to imposition of tax.* If gain that would be currently recognized pursuant to the provisions of this section or § 1.897-6T is subject to an exemption from (or reduction of)

U.S. tax pursuant to a U.S. income tax treaty, then gain shall be recognized only as provided by that treaty, for dispositions occurring before January 1, 1985. For dispositions occurring after December 31, 1984, all gain shall be recognized as provided in section 897 and the regulations thereunder, except as provided by Articles XIII (9) and XXX (5) of the United States-Canada Income Tax Convention or other income tax treaty entered into force after June 6, 1988.

With regard to Article XXX (5) of the Income Tax Treaty with Canada, see, Rev. Rul. 85-76, 1985-1 C.B. 409. With regard to basis adjustments for certain related person transactions, see, § 1.897-6T(c)(3).

(3) *Withholding.* Under sections 1441 and 1442, as modified by the provisions of any applicable U.S. income tax treaty, a corporation must withhold tax from a dividend distribution to which section 301 applies to a shareholder that is a foreign person, if the dividend is considered to be from sources inside the United States. For a description of dividends that are considered to be from sources inside the United States, see section 861(a)(2). Under section 1445, withholding is required with respect to certain dispositions and distributions of U.S. real property interests.

(4) *Effect on earnings and profits.* With respect to adjustments to earnings and profits for gain recognized to a distributing corporation on a distribution, see section 312 and the regulations thereunder.

(e) *Effective date.* Except as otherwise specifically provided in the text of these regulations, this section shall be effective for transfers, exchanges, distributions and other dispositions occurring after June 18, 1980.

[T.D. 8198, 53 FR 16217, May 5, 1988; 53 FR 18022, May 19, 1988; T.D. 9082, 68 FR 46084, Aug. 5, 2003]

§ 1.897-6T Nonrecognition exchanges applicable to corporations, their shareholders, and other taxpayers, and certain transfers of property in corporate reorganizations (temporary).

(a) *Nonrecognition exchanges—(1) In general.* Except as otherwise provided