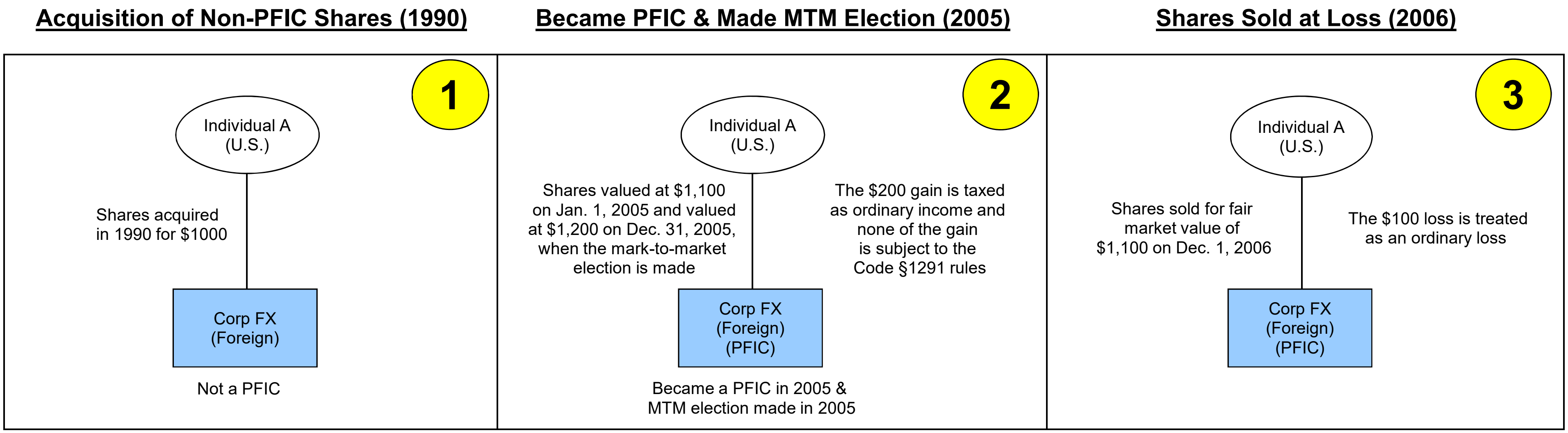
Reg. 1.1296-1(c)(7), Ex. 3

Ordinary Loss On Sale of 1296 Stock Because Loss Did Not Exceed Unreversed Inclusions



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 the stock in FX for $1,100. At that time, A's unreversed inclusions (the amount A included in income as mark to market gain) with respect to the stock in FX are $200. Accordingly, for taxable year 2006, A recognizes a loss on the sale of the FX stock of $100, (the fair market value of the FX stock ($1,100) minus A's adjusted basis ($1,200) in the stock) that is treated as an ordinary loss because the loss does not exceed the unreversed inclusions attributable to the stock of FX.