

§ 1.897-2 United States real property holding corporations.

(a) *Purpose and scope.* This section provides rules regarding the definition and consequences of U.S. real property holding corporation status. U.S. real property holding corporation status is important for determining whether gain from the disposition by a foreign person of an interest in a domestic corporation is taxable. Such status is also important for purposes of the withholding and reporting requirements of sections 1445 and 6039C. For example, a person that buys stock of a U.S. real property holding corporation from a foreign person is required to withhold under section 1445. In addition, for purposes of determining whether another corporation is a U.S. real property holding corporation, an interest in a foreign corporation is a U.S. real property interest unless it is established that the foreign corporation is not a U.S. real property holding corporation. The general definition of a U.S. real property holding corporation is provided in paragraph (b) of this section. Paragraph (c) provides rules regarding the dates on which U.S. real property holding corporation status must be determined. The assets that must be included in making the determination of a corporation's status are set forth in paragraph (d), while paragraph (e) provides special rules regarding the treatment of interests held by a corporation in partnerships, trusts, estates, and other corporations. Rules regarding the termination of U.S. real property holding corporation status are set forth in paragraph (f). Paragraph (g) explains the manner in which an interest-holder can establish that a corporation is not a U.S. real property holding corporation, and paragraph (h) provides rules regarding certain notification requirements applicable to corporations.

(b) *U.S. real property holding corporation—(1) In general.* A corporation is a U.S. real property holding corporation if the fair market value of the U.S. real property interests held by the corporation on any applicable determination date equals or exceeds 50 percent of the sum of the fair market values of its—

- (i) U.S. real property interests;
- (ii) Interests in real property located outside the United States; and

- (iii) Assets other than those described in subdivision (i) or (ii) of this paragraph (b)(1) that are used or held for use in its trade or business.

See paragraphs (d) and (e) of this section for rules regarding the directly and indirectly held assets that must be included in the determination of whether a corporation is a U.S. real property holding corporation. The term “interest in real property located outside the United States” means an interest other than solely as a creditor (as defined in § 1.897-1(d)) in real property (as defined in § 1.897-(b)) that is located outside the United States or the Virgin Islands. If a corporation qualifies as a U.S. real property holding corporation on any applicable determination date after June 18, 1980, any interest in it shall be treated as a U.S. real property interest for a period of five years from that date, unless the provisions of paragraph (f)(2) of this section are applicable.

(2) *Alternative test—(i) In general.* The fair market value of a corporation's U.S. real property interests shall be presumed to be less than 50 percent of the fair market value of the aggregate of its assets described in paragraphs (d) and (e) of this section if on an applicable determination date the total book value of the U.S. real property interests held by the corporation is 25 percent or less of the book value of the aggregate of the corporation's assets described in paragraphs (d) and (e) of this section.

(ii) *Definition of book value.* For purposes of this section and § 1.897-1(e) the term “book value” shall be defined as follows. In the case of assets that are held directly by the corporation, the term means the value at which an item is carried on the financial accounting records of the corporation, if such value is determined in accordance with generally accepted accounting principles applied in the United States. In the case of assets of which a corporation is treated as holding a pro rata share pursuant to paragraphs (e) (2) and (3) of this section and § 1.897-1(e), the term “book value” means the corporation's share of the value at which the asset is carried on the financial accounting records of the entity that directly holds the asset, if such value is

determined in accordance with generally accepted accounting principles applied in the United States. For purposes of this paragraph (b)(2)(ii), an entity need not keep all of its books in accordance with U.S. accounting principles, so long as the value of the relevant assets is determined in accordance therewith.

(iii) *Denial of presumption.* If the Internal Revenue Service determines, on the basis of information as to the fair market values of a corporation's assets, that the presumption allowed by this paragraph (b)(2) may not accurately reflect the status of the corporation, the Service will notify the corporation that it may not rely upon the presumption. The Service will provide a written notice to the corporation that sets forth the general grounds for the Service's conclusion that the presumption may be inaccurate. By the 90th day following the date on which the corporation receives the Service's notification, the corporation must determine whether on its most recent determination date it was a U.S. real property holding corporation pursuant to the general rule set forth in paragraph (b)(1) of this section and must notify the Service of its determination. If the corporation determines that it was not a U.S. real property holding corporation pursuant to the general rule, then the corporation may upon future determination dates rely upon the presumption allowed by this paragraph (b)(2), unless on the basis of additional information the Service again requests that the determination be made pursuant to the general rule. If the corporation determines that it was a U.S. real property holding corporation on its most recent determination date, then by the 180th day following the date on which the corporation received the Service's notification the corporation (if a domestic corporation) must notify each holder of an interest in it that contrary to any prior representations it was a U.S. real property holding corporation as of its most recent determination date.

(iv) *Applicability of penalties.* A corporation that had previously relied upon the presumption allowed by this paragraph (b)(2) but that is determined to be a U.S. real property holding cor-

poration shall not be subject to penalties for any incorrect notice previously given pursuant to the requirements of paragraph (h) of this section, if:

(A) The corporation in fact carried out the necessary calculations enabling it to rely upon the presumption allowed by this paragraph (b)(2); and

(B) The corporation complies with the provisions of paragraph (b)(2)(iii) of this section. However, a corporation shall remain subject to any applicable penalties if at the time of its reliance on the presumption allowed by this paragraph (b)(2) the corporation knew that the book value of relevant assets was substantially higher or lower than the fair market value of those assets and therefore had reason to believe that under the general test of paragraph (b)(1) of this section the corporation would probably be a U.S. real property holding corporation. Information with respect to the fair market value of its assets is known by a corporation if such information is included on any books and records of the corporation or its agent, is known by its directors or officers, or is known by employees who in the course of their employment have reason to know such information. A corporation relying upon the presumption allowed by this paragraph (b)(2) has no affirmative duty to determine the fair market values of assets if such values are not otherwise known to it in accordance with the preceding sentence. The rules of this paragraph (b)(2)(iv) may be illustrated by the following examples.

Example 1. DC is a domestic corporation engaged in light manufacturing that knows that it has foreign shareholders. On its December 31, 1985 determination date DC held assets used in its trade or business, consisting largely of recently-purchased equipment, with a book value of \$500,000. DC's only real property interest was a factory that it had occupied for over 50 years, which had a book value of \$200,000. The factory was located in a deteriorated downtown area, and DC had no knowledge of any facts indicating that the fair market value of the property was substantially higher than its book value. Therefore, DC was entitled to rely upon the presumption allowed by § 1.897-2(b)(2) and any incorrect statement pursuant to § 1.897-2(h) that arose out of such reliance would not give rise to penalties.

Example 2. The facts are the same as in Example 1, except as follows. By the time of DC's December 31, 1989 determination date, the downtown area in which DC's factory was located had become the subject of an extensive urban renewal program. On December 1, 1989, the president of DC was offered \$750,000 for the factory by a developer who planned to convert the property into condominiums. Because DC thus had knowledge of the fair market value of its assets which made it clear that the corporation would probably be a U.S. real property holding corporation under the general rule of § 1.897-2(b)(1), DC was not entitled to rely upon the presumption allowed by § 1.897-2(b)(2) after December 1, 1989, and any false statements arising out of such reliance thereafter would give rise to penalties.

(v) *Effect on interest-holders and related persons.* For the effect on interest holders and related persons of reliance on a statement issued by a corporation that made a determination as to whether it was a U.S. real property holding corporation under the provisions of § 1.897-2(b), see §§ 1.897-2(g)(1)(ii)(A) and 1.897-2(g)(2)(ii).

(c) *Determination dates for applying U.S. real property holding corporation test—(1) In general.* Whether a corporation is a U.S. real property holding corporation is to be determined as of the following dates:

(i) The last day of the corporation's taxable year;

(ii) The date on which the corporation acquires any U.S. real property interest;

(iii) The date on which the corporation disposes of an interest in real property located outside the United States or disposes of other assets used or held for use in a trade or business during the calendar year, subject to the provisions of paragraph (c)(2)(i) of this section; and

(iv) In the case of a corporation that is treated pursuant to paragraph (d)(4) or (5) of this section as owning a portion of the assets held by an entity in which the corporation directly or indirectly holds an interest, the date on which that entity either (A) acquires a U.S. real property interest, (B) disposes of an interest in real property located outside the United States or (C) disposes of other assets used or held for use in a trade or business during the calendar year, subject to the provisions of paragraph (c)(2)(ii) of this section. A

determination that is triggered by a transaction described in subdivision (ii), (iii), or (iv) of this paragraph (c)(1) must take such transaction into account. However, the first determination of a corporation's status need not be made until the 120th day after the later of the date of incorporation or of the date on which the corporation first acquires a shareholder. In addition, no determination of a corporation's status need be made during the 12-month period beginning on the date on which a corporation adopts a plan of complete liquidation, provided that all the assets of the corporation (other than assets retained to meet claims) are distributed within such period.

(2) *Transactions not requiring a determination—(i) Transactions by corporation.* Notwithstanding the provisions of paragraph (c)(1) of this section, a determination of U.S. real property holding corporation status need not be made on the date of:

(A) A corporation's disposition of inventory or livestock (as described in § 1.897-1(f)(1)(i) (A) and (C));

(B) The satisfaction of accounts receivable arising from the disposition of inventory or livestock or from the performance of services;

(C) The disbursement of cash to meet the regular operating needs of the business (e.g., to acquire inventory or to pay wages and salaries);

(D) A corporation's disposition of assets used or held for use in a trade or business (other than inventory or livestock) not in excess of a limitation amount determined in accordance with the rules of subdivision (iii) of this paragraph (c)(2); or

(E) A corporation's acquisition of U.S. real property interests not in excess of a limitation amount determined in accordance with the rules of subdivision (iii) of this paragraph (c)(2).

(ii) *Transactions by entity other than corporation.* Notwithstanding the provisions of paragraph (c)(1)(iv) or (c)(2)(v) of this section, in the case of a corporation that is treated as owning a portion of the assets held by an entity in which the corporation directly or indirectly holds an interest, a determination of U.S. real property holding corporation status need not be made on the date of:

(A) The entity's disposition of inventory or livestock (as described in § 1.897-1(f)(1)(i) (A) and (C));

(B) The satisfaction of accounts receivable arising from the entity's disposition of inventory or livestock or from the performance of personal services;

(C) The entity's disbursement of cash to meet the regular operating needs of its business (e.g. to acquire inventory or to pay wages and salaries);

(D) The entity's disposition of assets used or held for use in a trade or business (other than inventory or livestock) not in excess of a limitation amount determined in accordance with the rules of subdivision (iii) of this paragraph (c)(2); or

(E) The entity's acquisition of U.S. real property interests not in excess of a limitation amount determined in accordance with the rules of subdivision (iii) of this paragraph (c)(2).

(iii) *Calculation of limitation amount.* The amount of assets used or held for use in a trade or business that may be disposed of, and the amount of U.S. real property interests that may be acquired, by a corporation or other entity without triggering a determination date shall be calculated in accordance with the following rules:

(A) If, in accordance with the provisions of paragraphs (d) and (e) of this section, a corporation on its most recent determination date was considered to hold U.S. real property interests having a fair market value that was less than 25 percent of the aggregate fair market value of all the assets it was considered to hold, then the applicable limitation amount shall be 10 percent of the fair market value of all trade or business assets or all U.S. real property interests (as applicable) held directly by the corporation or by another entity described in paragraph (c)(1)(iv) of this section on that determination date.

(B) If, in accordance with the provisions of paragraphs (d) and (e) of this section, a corporation on its most recent determination date was considered to hold U.S. real property interests having a fair market value that was equal to or greater than 25 and less than 35 percent of the aggregate fair market value of all the assets it was

considered to hold, then the applicable limitation amount shall be 5 percent of the fair market value of all trade or business assets or all U.S. real property interests (as applicable) held directly by the corporation or by another entity described in paragraph (c)(1)(iv) of this section on that determination date.

(C) If, in accordance with the provisions of paragraphs (d) and (e) of this section, a corporation on its most recent determination date was considered to hold U.S. real property interests having a fair market value that was equal to or greater than 35 percent of the aggregate fair market value of all the assets it was considered to hold, then the applicable limitation amount shall be 2 percent of the fair market value of all trade or business assets or all U.S. real property interests (as applicable) held directly by the corporation or by another entity described in paragraph (c)(1)(iv) of this section on that determination date.

(D) If a corporation is not a U.S. real property holding corporation under the alternative test of paragraph (b)(2) of this section (relating to the book value of the corporation's assets), then the applicable limitation shall be 10 percent of the book value of all trade or business assets or all U.S. real property interests (as applicable) held directly by the corporation or by another entity described in paragraph (c)(1)(iv) of this section on the most recent determination date.

Dispositions or acquisitions by the corporation or other entity of assets having a value less than the applicable limitation amount must be cumulated by the corporation or entity making such dispositions or acquisitions, and a determination must be made on the date of a transaction that causes the total of either type to exceed the applicable limitation. Once a determination is triggered by a transaction that causes the applicable limitation to be exceeded, the computation of the amount of trade or business assets disposed of or real property interests acquired after that date shall begin again at zero.

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

Example 1. DC is a domestic corporation, no class of stock of which is regularly traded on an established securities market, that knows that it has several foreign shareholders. As of December 31, 1984, DC holds U.S. real property interests with a fair market value of \$500,000, no real property interests located outside the U.S. and other assets used in its trade or business with a fair market value of \$1,600,000. Thus, the fair market value of DC's U.S. real property interests (\$500,000) is less than 25% (\$525,000) of the total (\$2,100,000) of DC's U.S. real property interests (\$500,000), interests in real property located outside the United States (zero), and assets used or held for use in a trade or business (\$1,600,000). DC is not a U.S. real property holding corporation, and under the rule of paragraph (c)(2)(i) of this section it may dispose of trade or business assets with a fair market value equal to 10 percent (\$160,000) of the total fair market value (\$1,600,000) of such assets held by it on its most recent determination date (December 31, 1984), without triggering a determination of its U.S. real property holding corporation status. Therefore, when DC disposes of \$60,000 worth of trade or business assets (other than inventory or livestock) on March 1, 1985, and again on April 1, 1985, no determination of its status is required on either date. However, when DC disposes of a further \$60,000 worth of such trade or business assets on May 1, its total dispositions of such assets (\$180,000) exceeds its applicable limitation amount, and DC is therefore required to determine its U.S. real property holding corporation status. On May 1, 1985, the fair market value of DC's U.S. real property interests (\$500,000) is greater than 25 percent (\$480,000) and less than 35 percent (\$672,000) of the total (\$1,920,000) of DC's U.S. real property interests (\$500,000), interests in real property located outside the United States (zero), and assets used or held for use in a trade or business (\$1,420,000). DC is still not a U.S. real property holding corporation, but must now compute its applicable limitation amount as of the May 1 determination date. Under the rule of paragraph (c)(2)(iii)(B) of this section, DC could now dispose of trade or business assets other than inventory or livestock with a total fair market value equal to 5 percent of the fair market value of all trade or business assets held by DC on the May 1 determination date. Therefore, disposition of such trade or business assets with a fair market value of more than \$71,000 (5 percent of \$1,420,000) will trigger a further determination date for DC.

Example 2. DC is a domestic corporation, no class of stock of which is regularly traded on an established securities market, that knows that it has several foreign shareholders. As of December 31, 1986, DC's only assets are a U.S. real property interest with a fair market value of \$300,000 other assets used or held for use in its trade or business with a fair

market value of \$600,000, and a 50 percent partnership interest in domestic partnership DP. DC's interest in DP constitutes a percentage ownership interest in the partnership of 50 percent, and pursuant to the rules of paragraph (e)(2) of this section DC is treated as owning a portion of the assets of DP determined by multiplying that percentage by the fair market value of DP's assets. As of December 31, 1986, DP's only assets are U.S. real property interests with a fair market value of \$120,000 and other assets used in its trade or business with a fair market value of \$380,000. As of its December 31, 1986, determination date, the fair market value (\$360,000) of the U.S. real property interests DC holds (\$300,000) and is treated as holding (\$80,000 [The fair market value of DP's U.S. real property interest (\$120,000) multiplied by DC's percentage ownership interest in DP (50 percent)]), is equal to 31 percent of the sum of the fair market values (\$1,150,000) of the U.S. real property interests DC holds and is treated as holding (\$360,000) DC's interest in real property located outside the United States (zero), and assets used or held for use in a trade or business that DC holds or is treated as holding (\$790,000 [\$600,000 (held directly) plus \$190,000 (DC's 50 percent share of assets used or held for use in a trade or business by DP)]). Thus, under the rules of paragraph (c)(2) (i) and (iii)(B) of this section DC may dispose of assets used or held for use in its trade or business with a fair market value equal to 5 percent (\$30,000) of the total fair market value (\$600,000) of such assets held directly by it on its most recent determination date (December 31, 1986), without triggering a determination of its U.S. real property holding corporation status. In addition, under the rules of paragraph (c)(2) (ii) and (iii)(A) of this section, a determination date for DC would not be triggered by DP's disposition of trade or business assets (other than inventory or livestock) with a fair market value equal to 5 percent (\$19,000) of the total fair market value (\$380,000) of such assets held by it as of DC's most recent determination date (December 31, 1986). However, any disposition of such assets by DP exceeding that limitation would trigger a determination of DC's U.S. real property holding corporation status. In addition under the rule of paragraph (c)(1)(iv) of this section, any disposition of a U.S. real property interest by DP would trigger a determination date for DC, while under the rule of paragraph (c)(2)(ii) of this section no disposition of inventory or livestock by DP would trigger a determination for DC.

(3) *Alternative monthly determination dates*—(i) *In general.* Notwithstanding the provisions of paragraphs (c) (1) and (2) of this section, a corporation may

choose to determine its U.S. real property holding corporation status in accordance with the rules of this paragraph (c)(3). In the case of a corporation that has determined that it is not a U.S. real property holding corporation pursuant to the alternative test of paragraph (b)(2) of this section (relating to the book value of the corporation's assets), the rules of this paragraph (c)(3) may be applied by using book values rather than fair market values in all relevant calculations.

(ii) *Monthly determinations.* A corporation that determines its U.S. real property holding corporation status in accordance with the rules of this paragraph (c)(3) must make a determination at the end of each calendar month.

(iii) *Transactional determinations.* A corporation that determines its U.S. real property holding corporation status in accordance with the rules of this paragraph (c)(3) must make a determination as of the date on which, pursuant to a single transaction (consisting of one or more transfers):

(A) U.S. real property interests are acquired, and/or

(B) Interests in real property located outside the U.S. and/or assets used or held for use in a trade or business are disposed of,

if the total fair market value of the assets acquired and/or disposed of exceeds 5 percent of the sum of the fair market values of the U.S. real property interests, interests in real property located outside the U.S., and assets used or held for use in a trade or business held by the corporation.

(iv) *Exceptions.* Notwithstanding any other provision of this paragraph (c)(3), the first determination of a corporation's status need not be made until the 120th day after the later of the date of incorporation or the date on which the corporation first acquires a shareholder. In addition, no determination of a corporation's status need be made during the 12-month period beginning on the date on which a corporation adopts a plan of complete liquidation, if all the assets of the corporation (other than assets retained to meet claims) are distributed within such period.

(4) *Valuation date methods—(i) In general.* For purposes of determining

whether a corporation is a U.S. real property holding corporation on any applicable determination date, the fair market value of the assets held by the corporation (in accordance with § 1.897-2(d)) as of that determination date must be used.

(ii) *Alternative valuation date method for determination dates other than the last day of the taxable year.* For purposes of paragraph (c)(4)(i) of this section, if an applicable determination date under paragraph (c) (1), (2), or (3) of this section is other than the last day of the taxable year, property may be valued as of the later of the last day of the previous taxable year or the date such property was acquired. For purposes of the determination date that falls on the last day of the taxable year, fair market value as of that date must always be used.

(iii) *Consistent methods.* The valuation date method selected under this paragraph (c)(4) for the first determination date in a taxable year must be used for all subsequent determination dates for such year. In addition, the valuation date method selected must be used for all property with respect to which the determination is made. The use of one method for one taxable year does not preclude the use of the other method for any other taxable year.

(5) *Illustrations.* The rules of this paragraph (c) are illustrated by the following examples:

Example 1. Nonresident alien individual C purchased 100 shares of stock of domestic corporation K on July 26, 1985. Although K has additional shares of common stock outstanding, its stock has never been traded on an established securities market. At all times during calendar year 1985, K's only assets were a parcel of U.S. real estate (parcel A) and a parcel of country Z real estate (parcel B). On December 31, 1985, the fair market value of parcel A was \$1,000,000 and the fair market value of parcel B was \$2,000,000. For purposes of determining whether K was a U.S. real property holding corporation during 1985, the only applicable determination date was December 31, 1985, because K did not make any acquisitions or dispositions described in paragraph (c)(1) of this section during the year. The test of paragraph (b) of this section is applied using the fair market value of the property held on that date. K was not a U.S. real property holding corporation during 1985 because as of December 31, 1985, the fair market value (\$1,000,000) of the

U.S. real property interests held by K did not equal or exceed 50 percent (\$1,500,000) of the sum (\$3,000,000) of the fair market value of K's U.S. real property interest (\$1,000,000), the interests in real property located outside the United States (\$2,000,000), plus other assets used or held for use by K in a trade or business (zero).

Example 2. The facts are the same as in example 1, except that on April 7, 1986, K purchased another parcel of U.S. real estate for \$2,000,000. K's purchase of real property on April 7 triggered a determination on that date. As provided in paragraph (c)(3)(i) of this section, K chooses to use the value of parcels A and B as of the previous December 31, while newly acquired parcel C must be valued as of its acquisition on April 7, 1986. On that date, K qualifies as a U.S. real property holding corporation, since the fair market value of its U.S. real property interests (\$3,000,000) exceeds 50 percent (\$2,500,000) of the sum (\$5,000,000) of the fair market value of K's U.S. real property interests (\$3,000,000), its interests in real property located outside the U.S. (\$2,000,000), and its other assets used or held for use in a trade or business (zero).

(d) *Assets held by a corporation.* The assets that must be included in the determination of whether a corporation is a U.S. real property holding corporation are the following:

(1) U.S. real property interests that are held directly by the corporation (including directly-held interests in foreign corporations that are treated as U.S. real property interests pursuant to the rules of paragraph (e)(1) of this section);

(2) Interests in real property located outside the United States that are held directly by the corporation;

(3) Assets used or held for use in a trade or business that are held directly by the corporation;

(4) A proportionate share of assets held through a partnership, trust, or estate pursuant to the rules of paragraph (e)(2) of this section; and

(5) A proportionate share of assets held through a domestic or foreign corporation in which a corporation holds a controlling interest, pursuant to the rules of paragraph (e)(3) of this section.

(e) *Special rules regarding assets held by a corporation—(1) Interests in foreign corporations.* For purposes only of determining whether any corporation is a U.S. real property holding corporation, an interest in a foreign corporation shall be treated as a U.S. real property interest unless it is established that

the interest was not a U.S. real property interest under the rules of this section on the applicable determination date. The rules of paragraph (g)(2) of this section must be complied with to establish that the interest is not a U.S. real property interest. However, regardless of whether an interest in a foreign corporation is treated as a U.S. real property interest for this purpose, gain or loss from the disposition of an interest in such corporation will not be treated as effectively connected with the conduct of a U.S. trade or business by reason of section 897(a). The rules of this paragraph (e)(1) are illustrated by the following examples. In each example, fair market value is determined as of the applicable determination dates under paragraph (c)(4)(i) of this section.

Example 1. Nonresident alien individual F holds all of the stock of domestic corporation DC. DC's only assets are 40 percent of the stock of foreign corporation FC, with a fair market value of \$500,000, and a parcel of country W real estate, with a fair market value of \$400,000. Foreign corporation FP, unrelated to DC, holds the other 60 percent of the stock of FC. FC's only asset is a parcel of U.S. real estate with a fair market value of \$1,250,000. FC is a U.S. real property holding corporation because the fair market value of its U.S. real property interests (\$1,250,000) exceeds 50 percent (\$625,000) of the sum of the fair market values of its U.S. real property interests (\$1,250,000), its interests in real property located outside the United States (zero), plus its other assets used or held for use in a trade or business (zero). Consequently DC's interest in FC is treated as a U.S. real property interest under the rules of this paragraph (e)(1). DC is a U.S. real property holding corporation because the fair market value (\$500,000) of its U.S. real property interest (the stock of FC) exceeds 50 percent (\$450,000) of the sum (\$900,000) of the fair market value of its U.S. real property interests (\$500,000), its interests in real property located outside the United States (\$400,000), plus its other assets used or held for use in a trade or business (zero). If F disposes of her stock within 5 years of the current determination date, her gain or loss on the disposition of her stock in DC will be treated as effectively connected with a U.S. trade or business under section 897(a). However, FP's gain on the disposition of its FC stock would not be subject to the provisions of section 897(a) because the stock of FC is a U.S. real property interest only for purposes of determining whether DC is a U.S. real property holding corporation.

Example 2. Nonresident alien individual B holds all of the stock of domestic corporation US. US's only assets are 40 percent of the stock of foreign corporation FC1. Nonresident alien individual N, unrelated to US, holds the other 60 percent of FC1's stock. FC1's only assets are 40 percent of the stock of foreign corporation FC2. The remaining 60 percent of the stock of FC2 is owned by nonresident alien individual X, who is unrelated to FC1. FC2's only asset is a parcel of U.S. real estate with fair market value of \$1,000,000. FC2, therefore, is a U.S. real property holding corporation, and the stock of FC2 held by FC1 is a U.S. real property interest for purposes of determining whether FC1 is a U.S. real property holding corporation (but not for purposes of treating FC1's gain from the disposition of FC2 stock as effectively connected with a U.S. trade or business under section 897(a)). As all of FC1's assets are U.S. real property interests, the stock of FC1 held by US is a U.S. real property interest for purposes of determining whether US is a U.S. real property holding corporation (but not for purposes of subjecting N's gain on the disposition of FC1 stock to the provisions of section 897(a)). As US is a domestic corporation and as all of its assets are U.S. real property interests, US is a U.S. real property holding corporation, and the stock of US held by B is a U.S. real property interest for purposes of section 897(a). Therefore, B's gain or loss upon the disposition of the stock of US within 5 years of the most recent determination date is subject to the provisions of section 897(a).

(2) Proportionate ownership of assets held by partnerships, trusts, and estates. For purposes of determining whether a corporation is a U.S. real property holding corporation, a holder of an interest in a partnership, a trust, or an estate (whether domestic or foreign) shall be treated pursuant to section 897(c)(4)(B) as holding a proportionate share of the assets held by the entity.

However, a holder of an interest shall not be treated as holding a proportionate share of assets that in the hands of the entity are subject to the rule of § 1.897-1(f)(3)(ii) (concerning the trade or business assets of investment companies). Such proportionate share is to be determined in accordance with the rules of § 1.897-1(e) on each applicable determination date. The interest in the entity shall itself be disregarded when a proportionate share of the entity's assets is attributed to the interest-holder pursuant to the rule of this paragraph (e)(2). Any asset treated as

held by a holder of an interest by reason of this paragraph (e)(2) which is used or held for use in a trade or business by the partnership, trust, or estate shall be treated as so used or held for use by the holder of the interest. The proportionate ownership rule of this paragraph (e)(2) applies successively upward through a chain of ownership. The proportionate ownership rule of this paragraph (e)(2) is illustrated by the following examples. In each example fair market value is determined as of the applicable determination date under paragraph (c)(4)(i) of this section.

Example 1. Nonresident alien individual F holds all of the stock of domestic corporation DC. DC is a partner in foreign partnership FP, and DC's percentage ownership interest in FP is 50 percent. DC's other assets are a parcel of country F real estate with a fair market value of \$500,000 and other assets which it uses in its business with a fair market value of \$100,000. FP's assets are a parcel of country Z real estate with a fair market value of \$300,000 and a parcel of U.S. real estate with a fair market value of \$2,000,000. For purposes of determining whether DC is a U.S. real property holding corporation, DC is treated as holding its pro rata share of the assets held by FP. DC's pro rata share of the U.S. real estate held by FP is \$1,000,000, determined by multiplying the fair market value (\$2,000,000) of the U.S. real property interests held by FP by DC's percentage ownership interest in FP (50 percent). DC's pro rata share of the country Z real estate held by FP is \$150,000, determined in the same manner. DC is a U.S. real property holding corporation because the fair market value (\$1,000,000) of its U.S. real property interests (the U.S. real estate it is treated as holding proportionately) exceeds 50 percent (\$875,000) of the sum (\$1,750,000) of the fair market value of its U.S. real property interests (\$1,000,000), its interests in real property located outside the United States [(\$650,000) (its country F real estate and its pro rata share of the country Z real estate)], plus its other assets which are used or held for use in a trade or business (\$100,000). Because DC is a domestic U.S. real property holding corporation, the stock of DC is a U.S. real property interest and F's gain or loss on the disposition of this DC stock within 5 years of the current determination date will be treated as effectively connected with a U.S. trade or business under section 897(a).

Example 2. Nonresident alien individual B holds all of the stock of domestic corporation US. US is a beneficiary of foreign trust FT. US's percentage ownership interest in FT is 90 percent. US has no other assets. FT

is a partner in domestic partnership DP. FT's percentage ownership interest in DP is 30 percent. FT has no other assets. DP's only asset is a parcel of U.S. real estate with a fair market value of \$1,000,000. FT is treated as holding U.S. real estate with a fair market value of \$300,000 (30 percent of the U.S. real estate held by DP with a fair market value of \$1,000,000). For purposes of determining whether US is a U.S. real property holding corporation, the proportionate ownership rule is applied successively upward through the chain of ownership. Thus, US is treated as holding 90 percent of FT's \$300,000 pro rata share of the U.S. real estate held by DP. US is a U.S. real property holding corporation because the fair market value (\$270,000) of its U.S. real property interests (its pro rata share of the U.S. real estate held by DP) exceeds 50 percent (\$135,000) of the sum of the fair market values of its U.S. real property interests (\$270,000), its interests in real property located outside the United States (zero), plus its other assets used or held for use in a trade or business (zero). Because US is a domestic U.S. real property holding corporation, the stock of US is a U.S. real property interest, and B's gain or loss from the disposition of US stock within 5 years of the current determination date will be treated as effectively connected with a U.S. trade or business under section 807(a).

(3) *Controlling interests in corporations.* For purposes only of determining whether a corporation is a U.S. real property holding corporation, if the corporation (the "first corporation") holds a controlling interest in a second corporation—

(i) The first corporation is treated as holding a proportionate share of each asset (i.e., U.S. real property interests, interests in real property located outside the United States, and assets used or held for use in a trade or business) held by the second corporation, determined in accordance with the rules of § 1.897-1(e);

(ii) Any asset so treated as held proportionately by the first corporation which is used or held for use by the second corporation in a trade or business shall be treated as so used or held for use by the first corporation; and

(iii) Interests in the second corporation held by the first corporation are not themselves taken into account as U.S. real property interests (regardless of whether the second corporation is a U.S. real property holding corporation) or as trade or business assets. However,

the first corporation shall not be treated as holding a proportionate share of assets that in the hands of the second corporation are subject to the rules of § 1.897-1(f)(3)(ii) (concerning the trade or business assets of investment companies). A determination of what portion of the assets of the second corporation are considered to be held by the first corporation shall be made as of the applicable dates for determining whether the first corporation is a U.S. real property holding corporation.

A "controlling interest" means 50 percent or more of the fair market value of all classes of stock of the corporation, determined as of the applicable determination date. In determining whether a corporation holds a controlling interest in another corporation, section 318(a) shall apply (except that sections 318(a)(2)(C) and (3)(C) are applied by substituting the phrase "5 percent" for "50 percent"). However, a corporation that does not directly hold any interest in a second corporation shall not be treated as holding a controlling interest in the second corporation by reason of the application of section 318(a)(3)(C). The rules of this paragraph (e)(3) apply successively upward through a chain of ownership. For example, if the second corporation owns a controlling interest in a third corporation, the rules of this paragraph shall be applied first to determine the portion of the assets of the third corporation that is considered to be held by the second corporation and then to determine the portion of the assets held and considered to be held by the second corporation that is considered to be held by the first corporation. The controlling interest rules of this paragraph (e)(3) apply, regardless of whether a corporation is domestic or foreign, whenever it is necessary to determine whether a corporation is a U.S. real property holding corporation. The rules of this paragraph (e)(3) are illustrated by the following examples. In each example fair market value is determined as of the applicable determination date under paragraph (c)(4)(i) of this section and no corporation holds constructively any interest not specified in the example.

Example 1. Nonresident alien individual N owns all of the stock of domestic corporation

DC. DC's only assets are 60 percent of the fair market value of all classes of stock of foreign corporation FS and 60 percent of the fair market value of all classes of stock of domestic corporation DS. The percentage ownership interest of DC in each of FS and DS is 60 percent. The balance of the stock in FS and DS is held by nonresident alien individual B, who is unrelated to DC. FS's only asset is a parcel of country F real estate with a fair market value of \$1,000,000. DS's only asset is a parcel of U.S. real estate with a fair market value of \$2,000,000. The value of DC stock in FS and DS is not taken into account for purposes of determining whether DC is a U.S. real property holding corporation. Rather, because DC holds a controlling interest (60 percent) in each of FS and DS, DC is treated as holding a portion of each asset held by FS and DS. DC's portion of the country F real estate held by FS is \$600,000, determined by multiplying the fair market value (\$1,000,000) of the country F real estate by DC's percentage ownership interest (60 percent). Similarly, DC's portion of the U.S. real estate held by DS is \$1,200,000 (60 percent of \$2,000,000). DC is a U.S. real property holding corporation, because the fair market value (\$1,200,000) of its U.S. real property interests (its portion of the U.S. real estate) exceeds 50 percent (\$900,000) of the sum (\$1,800,000) of the fair market values of its U.S. real property interests (\$1,200,000), its interests in real property located outside the United States (the \$600,000 portion of country F real estate), plus its other assets used or held for use in a trade or business (zero). Because DC is a domestic U.S. real property holding corporation, the stock of DC is a U.S. real property interest, and N's gain or loss on the disposition of DC stock within 5 years of the current determination date would be treated as effectively connected with a U.S. trade or business under section 897(a).

Example 2. (i) Nonresident alien individual F owns all of the stock of domestic corporation US1. US1's only asset is 85 percent of the fair market value of all classes of stock of domestic corporation US2. US2's only assets are 60 percent of the fair market value of all classes of stock of domestic corporation US3, with a fair market value of \$600,000, and a parcel of country D real estate with a fair market value of \$800,000. US3's only asset is a parcel of U.S. real estate with a fair market value of \$2,000,000. The percentage ownership interest of F in US1 is 100 percent.

Although US1 owns 85 percent of the stock of US2, US1's percentage ownership interest in US2 is 75 percent, because US2 has other interests other than solely as a creditor outstanding. US2's percentage ownership interest in US3 is 60 percent.

(ii) US2 holds a controlling interest in US3, since it holds more than 50 percent of the fair market value of all classes of stock of US3. Consequently, the value of US2's stock in US3 is not taken into account in determining whether US2 is a U.S. real property holding corporation, even though US3 is a U.S. real property holding corporation. Instead, US2 is treated as holding a portion of the U.S. real estate held by US3. US2's portion of the U.S. real estate is \$1,200,000, determined by multiplying US2's percentage ownership interest (60 percent) by the fair market value (\$2,000,000) of the U.S. real estate. US1 holds a controlling interest in US2 (75 percent.). By reapplying the rules of paragraph (e)(3) of this section successively upward through the chain of ownership, US1's stock in US2 is not taken into account, and US1 is treated as holding a portion of the country D real estate held by US2 and the U.S. real estate which US2 is treated as holding proportionately. US1's portion of the country D real estate is \$600,000, determined by multiplying US1's percentage ownership interest (75 percent) by the fair market value (\$800,000) of the country D real estate. US1's portion of the U.S. real estate which US2 is treated as owning is \$900,000, determined by multiplying US1's percentage ownership interest (75 percent) by the fair market value (\$1,200,000) of US2's portion of U.S. real estate held by US3. US1 is a U.S. real property holding corporation, because the fair market value (\$900,000) of its U.S. real property interests (its portion of US2's portion of U.S. real estate) is more than 50 percent (\$750,000) of the sum (\$1,500,000) of fair market values of its U.S. real property interests (\$900,000), its interests in real property located outside the United States (\$800,000), plus its other assets need or held for use in a trade or business (zero). Because US1 is a U.S. real property holding corporation and is a domestic corporation, the stock of US1 is a U.S. real property interest, and F's gain or loss on the disposition of US1 stock within 5 years of the current determination date will be treated as effectively connected with a U.S. trade or business under section 897(a).

Example 3. Nonresident alien individual B holds all of the stock of domestic corporation DC. DC's only assets are 40 percent of the fair market value of all classes of stock of foreign corporation FC and a parcel of country R real estate with a fair market value of \$100,000. FC's only asset is one parcel of U.S. real estate with a fair market value of \$1,000,000. The fair market value of the FC stock held by DC is \$200,000. FC is a U.S. real property holding corporation. Since DC does not hold a controlling interest in FC, the controlling interest rules of paragraph (e)(3) of this section do not apply to treat DC as holding a portion of the U.S. real estate held by FC. However, because FC is a U.S. real property holding corporation, the

stock of FC is a U.S. real property interest for purposes of determining whether DC is a U.S. real property holding corporation. DC is a U.S. real property holding corporation because the fair market value (\$200,000) of its U.S. real property interest (the stock of FC) exceeds 50 percent (\$150,000) of the sum (\$300,000) of the fair market values of its U.S. real property interest (\$200,000), its interests in real property located outside the United States (\$100,000), plus its other assets used or held for use in a trade or business (zero). Because DC is a U.S. real property holding corporation and is a domestic corporation, its stock is a U.S. real property interest, and B's gain or loss on the disposition of DC stock within 5 years of the current determination date would be subject to the provisions of section 897(a).

Example 4. Nonresident alien individual C owns all of the stock of domestic corporation DC1. DC1's only assets are 25 percent of the fair market value of all classes of stock of domestic corporation DC2, and a parcel of U.S. real estate with a fair market value of \$100,000. The stock of DC2 is not an asset used or held for use in DC1's trade or business. DC2's only assets are a building located in the U.S. with a fair market value of \$100,000 and manufacturing equipment and inventory with a fair market value of \$200,000. DC2 is not a U.S. real property holding corporation. Since DC1 does not hold a controlling interest in DC2, the rules of this paragraph (e)(3) do not apply to treat DC1 as holding a portion of the assets held by DC2. In addition, since DC2 is not a U.S. real property corporation, its stock does not constitute a U.S. real property interest. Therefore, for purposes of determining whether DC1 is a real property holding corporation, its interest in DC2 is not taken into account. Since DC1's only other asset is a parcel of U.S. real estate, DC1 is a U.S. real property holding corporation, and C's gain or loss on the disposition of DC1 stock within 5 years of the current determination date would be subject to the provisions of section 897(a).

(4) *Co-application of rules of this paragraph (e).* The rules of this paragraph (e) apply in conjunction with one another for purposes of determining whether a corporation is a U.S. real property holding corporation. The rule of this paragraph (e)(4) is illustrated by the following example. In the example fair market value is determined as of the applicable determination date in accordance with paragraph (c)(4)(i) of this section.

Example. Nonresident alien individual B holds 100 percent of the stock of domestic corporation US. US's only asset is 10 percent of the stock of foreign corporation FC1.

FC1's only asset is 100 percent of the stock of foreign corporation FC2. FC2's only asset is a 50 percent interest in domestic partnership DP. FC2's percentage ownership interest in DP is 50 percent. DP's only asset is a parcel of U.S. real estate with a fair market value of \$10,000,000. In determining whether US is a U.S. real property holding corporation, the rules of this paragraph (e) apply in conjunction with one another. Consequently, under paragraph (e)(2) of the section FC2 is treated as holding U.S. real estate with a fair market value of \$5,000,000 (50 percent of \$10,000,000, its pro rata share of real estate held by DP). Under paragraph (e)(3) of this section, FC1 is treated as holding 100 percent of the assets of FC2 (U.S. real estate with a fair market value of \$5,000,000). FC1, therefore, is a U.S. real property holding corporation. Under paragraph (e)(1) of this section, the stock of FC1 is treated as U.S. real property interest. US is a U.S. real property holding corporation because 100 percent of its assets (the stock of FC1) are U.S. real property interests. As US is a U.S. real property holding corporation and is a domestic corporation, the stock of US is a U.S. real property interest, and B's gain or loss from the disposition of stock of US within 5 years of the current determination date will be subject to the provisions of section 897(a).

(f) *Termination of U.S. real property holding corporation status—(1) In general.* A U.S. real property holding corporation may voluntarily determine its status as of the date of any acquisition or disposition of assets. If the fair market value of its U.S. real property interests on such date no longer equals or exceeds 50 percent of the fair market value of all assets described in paragraphs (d) and (e) of this section, such corporation shall cease to be U.S. real property holding corporation as of such date, and on the day that is five years after such date interests in such corporation shall cease to be treated as U.S. real property interests (unless subsequent transactions within the five-year period have caused the fair market value of the corporation's U.S. real property interests to equal or exceed 50 percent of the fair market value of assets described in paragraphs (d) and (e) of this section). A corporation that determines that interests in it have ceased to be U.S. real property interests pursuant to the rules of this paragraph (f) may so inform the Internal Revenue Service, as provided in paragraph (h) of this section.

(2) *Early termination.* Interests in a U.S. real property holding corporation shall immediately cease to be U.S. real property interests as of the first date on which the following conditions are met—

(i) The corporation does not hold any U.S. real property interests, and

(ii) All of the U.S. real property interests directly or indirectly held by such corporation at any time during the previous five years (but disregarding any disposed of before June 19, 1980) either (A) were directly or indirectly disposed of in transactions in which the full amount of the gain (if any) was recognized or (B) ceased to be U.S. real property interests by reason of the application of this paragraph (f) to one or more other corporations.

For purposes of this paragraph (f)(2), a corporation that disposes of all U.S. real property interests other than a lease that has a fair market value of zero will be considered to have disposed of all of its U.S. real property interests, provided that the leased property is used in the conduct by the corporation of a trade or business in the United States. Such a lease may include an option to renew, but only if such option is for a renewal at fair market rental rates prevailing at the time of renewal.

(g) *Establishing that a corporation is not a U.S. real property holding corporation—*(1) *Foreign persons disposing of interests—*(i) *In general.* A foreign person disposing of an interest in a domestic corporation (other than an interest solely as a creditor) must establish that the interest was not a U.S. real property interest as of the date of disposition, either by:

(A) Obtaining a statement from the corporation pursuant to the provisions of subdivision (ii) of this paragraph (g)(1), or

(B) Obtaining a determination by the Commissioner, Small Business/Self Employed Division (SB/SE) pursuant to the provisions of subdivision (iii) of this paragraph (g)(1).

If the foreign person does not establish by either method that the interest disposed of was not a U.S. real property interest then the interest shall be presumed to have been a U.S. real property interest the disposition of which is

subject to section 897(a). See paragraph (g)(3) of this section for certain exceptions to this rule. It should be noted that the rules of this section relate solely to interests in a corporation that are interests other than solely as a creditor. Therefore, a statement by a corporation or a determination by the Commissioner (under paragraphs (g) or (h) of this section) that an interest is not a U.S. real property interest depends solely upon whether or not the corporation was a U.S. real property holding corporation during the period described in section 897(c)(1)(A)(ii) (subject to certain special rules). The determination of whether an interest is one solely as a creditor is made under the rules of § 1.897-1(d).

(ii) *Statement from corporation—*(A) *In general.* A foreign person disposing of an interest in a domestic corporation may establish that the interest was not a U.S. real property interest as of the date of the disposition by requesting and obtaining from the corporation a statement that the interest was not a U.S. real property interest as of that date. However, a corporation's statement shall not be valid for purposes of this rule, and thus may not be relied upon for purposes of establishing that an interest was not a U.S. real property interest, unless the corporation complies with the notice requirements of paragraph (h) (2) or (h)(4) of this section.

A foreign person that requests and obtains such a statement is not required to forward the statement to the Internal Revenue Service and is not required to take any further action to establish that the interest disposed of was not a U.S. real property interest. To qualify under this rule, the foreign person must obtain the corporation's statement no later than the date, including any extensions, on which a tax return would otherwise be due with respect to a disposition. A foreign person that relies in good faith upon a statement from the corporation is not thereby excused from filing a return and paying any taxes and interest due thereon if the corporation's statement is later found to have been incorrect. However, such reliance shall be taken into account in determining whether the foreign person shall be subject to

any penalty for the previous failure to file. However, a foreign person that knew or had reason to know that a corporation's statement was incorrect is not entitled to rely upon such statement and shall remain liable for all applicable penalties.

(B) *Coordination with section 1445.* Pursuant to section 1445 and regulations thereunder, withholding of tax is not required with respect to a foreign person's disposition of an interest in a domestic corporation, if the transferee is furnished with a statement by the corporation under paragraph (h) of this section that the interest is not a U.S. real property interest. A foreign person that obtains a corporation's statement for that purpose prior to the date of disposition may also rely upon the statement for purposes of this paragraph (g)(1)(ii), unless the corporation informs the foreign person (pursuant to paragraph (h)(1)(iv)(C) of this section) that it became a U.S. real property holding corporation after the date of the notice but prior to the actual date of disposition.

(iii) *Determination by Commissioner—*

(A) *In general.* A foreign person disposing of an interest in a domestic corporation may establish that the interest was not a U.S. real property interest as of the date of disposition by requesting and obtaining a determination to that effect from the Commissioner. Such a determination may be requested pursuant to the provisions of subdivision (B) or (C) of this paragraph (g)(1)(iii). A request for a determination should be addressed to: Commissioner, Small Business/Self Employed Division (SB/SE); S C3-413 NCFB, 500 Ellin Road, Lanham, MD 20706. A foreign transferor who has requested a determination by the Commissioner pursuant to the rules of this paragraph (g)(1)(iii) is not thereby excused from filing a return and paying any tax due by the date, including any extensions, on which such return and payment would otherwise be due with respect to a disposition. If the Commissioner subsequently determines and notifies the foreign transferor that the interest was not a U.S. real property interest, the foreign transferor shall be entitled to a refund of any taxes, penalties, and interest paid by reason of the application

of section 897(a) pursuant to the rules of paragraph (g)(1)(i) of this section, together with any interest otherwise due on such refund, if a claim for refund is made within the applicable time limits.

(B) *Determination based on Commissioner's information.* A foreign person may request that the Commissioner make a determination based on information contained in the Commissioner's records, if:

(1) The foreign person made a request to the corporation for information as to the status of its interest no later than the 90th day before the date, including any extensions, on which a tax return would otherwise be due with respect to a disposition, and

(2) The corporation failed to respond to such request by the 30th day following the date the request was delivered to the corporation.

If the Commissioner is unable to make a determination based on information available to him, he shall inform the foreign person that the interest must be treated as a U.S. real property interest unless the person subsequently obtains either the necessary statement from the corporation or a determination pursuant to subdivision (C) of this paragraph (g)(1)(iii).

(C) *Determination based on information supplied by foreign person.* A foreign person may request that the Commissioner make a determination based on information supplied by the foreign person. Such information may be drawn, for example, from annual reports, financial statements, or records of the corporation, and must establish to the satisfaction of the Commissioner that the foreign person's interest was not a U.S. real property interest as of the date of disposition.

(D) *Determination by Commissioner on his own motion.* Notwithstanding any other provision of this section, a foreign person shall not treat the disposition of an interest in a domestic corporation as a disposition of a U.S. real property interest if such person is notified that the Commissioner has upon his own motion determined that the interest was not a U.S. real property interest as of the date of disposition.

(2) *Corporations determining U.S. real property holding corporation status—(i)*

In general. A corporation that must determine whether it is a U.S. real property holding corporation, and that holds an interest in another corporation (other than a controlling interest as defined in paragraph (e)(3) of this section), must determine whether or not that interest was a U.S. real property interest as of its own determination date, by either:

(A) Obtaining a statement from the second corporation pursuant to the provisions of subdivision (ii) of this paragraph (g)(2);

(B) Obtaining a determination by the Commissioner pursuant to the provisions of subdivision (iii) of this paragraph (g)(2); or

(C) Making an independent determination pursuant to the provisions of subdivision (iv) of this paragraph (g)(2). A corporation that is unable to determine by any of the above methods whether its interest in a second corporation is a U.S. real property interest must presume that such interest is a U.S. real property interest.

(ii) *Statement from corporation.* A corporation may determine whether or not an interest in a second corporation was a U.S. real property interest as of its own determination date by obtaining from the second corporation a statement that the interest was not a U.S. real property interest as of that date. However, the second corporation's statement shall not be valid for purposes of this rule, and thus may not be relied upon for purposes of establishing that an interest was not a U.S. real property interest, unless such corporation complies with the notice requirements of paragraph (h)(2) or (h)(4) of this section.

A corporation that requests and obtains such a statement is not required to forward the statement to the Internal Revenue Service and is not required to take any further action to establish that the interest in the second corporation was not a U.S. real property interest. If the second corporation's statement is later found to have been incorrect, the first corporation shall not be subject to penalties arising out of past failures to comply with the requirements of section 897 or 1445, if such failures were attributable to reliance upon the second corporation's

statement. By the 90th day following receipt of a notification from the Service or from the second corporation that a prior statement was incorrect, the first corporation must redetermine its status (as of its most recent determination date) and if appropriate notify the Internal Revenue Service that it is a U.S. real property holding corporation in accordance with paragraph (h)(1)(ii)(C) of this section. However, a corporation that knew or had reason to know that a second corporation's statement was incorrect is not entitled to rely upon such statement and shall remain liable for all applicable taxes, penalties, and interest arising out of the second corporation's status as a U.S. real property holding corporation.

(iii) *Determination by Commissioner—*
 (A) *In general.* A corporation may determine whether or not an interest in a second corporation was a U.S. real property interest as of its own determination date by requesting and obtaining a determination to that effect from the Commissioner. Such a determination may be requested pursuant to the provisions of subdivision (B) or (C) of this paragraph (g)(2)(iii). A request for a determination must be addressed to: Commissioner, Small Business/Self Employed Division (SB/SE); S C3-413 NCFB, 500 Ellin Road, Lanhan, MD 20706. A corporation that has requested a determination by the Commissioner pursuant to the provisions of this paragraph is not thereby excused from taking any action required by section 897 or 1445 by the date on which such action would otherwise be due. However, the Commissioner may grant a reasonable extension of time for the satisfaction of any requirement if the Commissioner is satisfied that the corporation has not sought a determination pursuant to this paragraph (g)(2)(iii) for a principal purpose of delay.

(B) *Determination based on Commissioner's information.* A corporation may request that the Commissioner make a determination based on information contained in the Commissioner's records, if:

(1) The corporation made a request to the second corporation for information as to the status of its interest no later than the fifth day following the first corporation's determination date, and

(2) The second corporation failed to respond to such request by the 30th day following the date the request was delivered to the second corporation.

Pending his resolution of such a request, the Commissioner will generally grant an extension with respect to the change-of-status notification that may otherwise be required pursuant to paragraph (h)(1)(ii) of this section. If the Commissioner is unable to make a determination based on information available to him, he shall inform the corporation that the interest must be treated as a U.S. real property interest unless the corporation subsequently obtains either the necessary statement from the second corporation or a determination pursuant to paragraph (g)(2)(iii)(C) or (g)(2)(iv) of this section.

(C) *Determination based on information supplied by corporation.* A corporation may request that the Commissioner make a determination based on information supplied by the corporation. Such information may be drawn, for example, from annual reports, financial statements, or records of the second corporation, and must establish to the satisfaction of the Commissioner that the interest in the second corporation was not a U.S. real property interest as of the first corporation's determination date.

(D) *Determination by Commissioner on his own motion.* Notwithstanding any other provision of this section, a corporation shall not treat an interest in a second corporation as a U.S. real property interest if the corporation is notified that the Commissioner has upon his own motion determined that the interest in the second corporation is not a U.S. real property interest.

(iv) *Independent determination by corporation.* A corporation may independently determine whether or not an interest in a second corporation was a U.S. real property interest as of the first corporation's own determination date. Such determination must be based upon the best evidence available, drawn from annual reports, financial statements, records of the second corporation, or from any other source, that demonstrates to a reasonable certainty that the interest in the second corporation was not a U.S. real property interest. A corporation that

makes an independent determination pursuant to this paragraph (g)(2)(iv) shall be subject to the special notification rule of paragraph (h)(1)(iii)(D) of the section. If the Commissioner subsequently determines that the corporation's independent determination was incorrect, the corporation shall be subject to penalties for any past failure to comply with the requirements of section 897 or 1445 only if the corporation's determination was unreasonable in view of facts that the corporation knew or had reason to know.

(3) *Requirements not applicable.* If at any time during the calendar year any class of stock of a corporation is regularly traded on an established securities market, the requirements of this paragraph (g) shall not apply with respect to any holder of an interest in such corporation other than a person who holds an interest described in § 1.897-1(c)(2)(iii) (A) or (B). For example, a corporation determining whether it is a U.S. real property holding corporation need not ascertain from a regularly traded corporation in which it neither holds, nor has held during the period described in section 897(c)(1)(A)(ii), more than a 5 percent interest whether that regularly traded corporation is itself a U.S. real property holding corporation.

In addition, the requirements of this paragraph (g) do not apply to any holder of an interest in a domestically-controlled RETT, as defined in section 897(h)(4)(B).

(h) *Notice requirements applicable to corporations—(1) Statement to foreign interest-holder—(i) In general.* A domestic corporation must, within a reasonable period after receipt of a request from a foreign person holding an interest in it, inform that person whether the interest constitutes a U.S. real property interest. No particular form is required for this statement, which need only indicate the corporation's determination. The statement must be dated and signed by a responsible corporate officer who must verify under penalties of perjury that the statement is correct to his knowledge and belief.

(ii) *Required determination.* For purposes of the statement required by paragraph (h)(1)(i) of this section, an interest in a corporation is a U.S. real

property interest if the corporation was a U.S. real property holding corporation on any determination date during the 5-year period ending on the date specified in the interest-holder's request, or on the date such request was received if no date is specified (or during such shorter period ending on the date that is applicable pursuant to section 897(c)(1)(A)(ii). However, an interest in a corporation is not a U.S. real property interest if such interest is excluded under section 897(c)(1)(B).

(2) *Notice to the Internal Revenue Service.* If a foreign interest holder requests that a domestic corporation provide a statement described in paragraph (h)(1) of this section, then such corporation must provide a notice to the Internal Revenue Service in accordance with this paragraph (h)(2). No particular form is required for such notice, but the following must be provided:

(i) A statement that the notice is provided pursuant to the requirements of § 1.897-2(h)(2);

(ii) The name, address, and identifying number of the corporation providing the notice;

(iii) The name, address, and identifying number (if any) of the foreign interest holder that requested the statement (this information may be omitted from the notice if fully set forth in the statement to the foreign interest holder attached to the notice).

(iv) Whether the interest in question is a U.S. real property interest;

(v) A statement signed by a responsible corporate officer verifying under penalties of perjury that the notice (including any attachments thereto) is correct to his knowledge and belief. A copy of any statement provided to the foreign interest holder must be attached to the notice. The notice must be mailed to the Director, Philadelphia Service Center, P.O. Box 21086, Drop Point 8731, FIRPTA Unit, Philadelphia, PA 19114-0586 on or before the 30th day after the statement referred to in § 1.897-2(h)(1) is mailed to the interest holder that requested it. Failure to mail such notice within the time period set forth in the preceding sentence will cause the statement provided pursuant to § 1.897-2(h)(1) to become an invalid statement.

(3) *Requirements not applicable.* The requirements of this paragraph (h) do not apply to domestically-controlled REITS, as defined in section 897(h)(4)(B). These requirements also do not apply to a corporation any class of stock in which is regularly traded on an established securities market at any time during the calendar year. However, such a corporation may voluntarily choose to comply with the requirements of paragraph (h)(4) of this section.

(4) *Voluntary notice to Internal Revenue Service—(i) In general.* A domestic corporation which determines that it is not a U.S. real property holding corporation—

(A) On each of the applicable determination dates in a taxable year, or

(B) Pursuant to section 897(c)(1)(B), may attach to its income tax return for that year a statement informing the Internal Revenue Service of its determination. A corporation that has provided a voluntary notice described in this § 1.897-2(h)(4)(i) for the immediately preceding taxable year and that does not have an event described in § 1.897-2(c)(1) (ii), (iii) or (iv) prior to receiving a request from a foreign person under § 1.897-2(h)(1), is exempt from the notice requirement of § 1.897-2(h)(2).

(ii) *Early termination of real property holding corporation status.* A corporation that determines during the course of its taxable year that interests in it have ceased to be U.S. real property interests pursuant to the rules of section 897(c)(1)(B) may, on the day of its determination or thereafter, provide a statement to the Director, Philadelphia Service Center, P.O. Box 21086, Drop Point 8731, FIRPTA Unit, Philadelphia, PA 19114-0586, informing the Service of its determination. No particular form is required but the statement must set forth the corporation's name, address, identification number, a brief statement regarding its determination and the date such determination was made. Such statement will enable foreign interest-holders to dispose of their interests without being subject to section 897(a), as provided in paragraph (g) of this section.

(5) *Supplemental statements—(i) By corporations with substantial intangible assets.* A corporation that is subject to

the requirements of paragraph (h)(2) of this section (or that voluntarily complies with the requirements of paragraph (h)(4) of this section) must submit a supplemental statement to the Internal Revenue Service if—

(A) Such corporation values any of the intangible assets described in § 1.897-1(f)(1)(ii) (other than goodwill or going concern value) by a method other than the purchase price or book value methods described in § 1.897-1(o)(4); and

(B) The fair market value of such intangible assets equals or exceeds 25 percent of the total of the fair market values of the assets the corporation is considered to hold in accordance with the provisions of paragraphs (d) and (e) of this section.

The supplemental statement must inform the Internal Revenue Service that the corporation meets the criteria of subdivisions (A) and (B) of this paragraph (h)(5)(i), and must summarize the methods and calculations upon which the corporation's determination of the fair market value of its intangible assets is based. In addition, the supplemental statement must list any intangible assets that were purchased from any person that have been valued by the corporation at an amount other than their purchase price, and must provide a justification for such a departure from the purchase price. The supplemental statement must be attached to or incorporated in the statement provided under paragraph (h)(2) or (h)(4) of this section.

(ii) *Corporation not valuing goodwill or going concern value at purchase price.* A corporation that is subject to the requirements of paragraph (h)(2) of this section (or that voluntarily complies with the requirements of paragraph (h)(4) of this section) must submit a supplemental statement to the Internal Revenue Service if such corporation values goodwill or going concern value pursuant to § 1.897-1(o)(4)(iii). The supplemental statement must set forth that it is made pursuant to this paragraph (h)(5)(ii), and must summarize the methods and calculations upon which the corporation's determination of the fair market value of such intangible assets is based. In addition, the supplemental statement must list any such assets that were purchased from

any person that have been valued by the corporation at an amount other than their purchase price, and must provide a justification for such a departure from the purchase price. The supplemental statement must be attached to or incorporated in the statement provided under paragraph (h)(2) or (h)(4) of this section.

(iii) *Corporation using alternative U.S. real property holding corporation test.* A corporation that is subject to the requirements of paragraph (h)(2) of this section (or that voluntarily complies with the requirements of paragraph (h)(4) of this section) must submit a supplemental statement to the Internal Revenue Service if—

(A) Such corporation utilizes the rule of paragraph (b)(2) of this section (regarding the book values of assets held by the corporation) to presume that it is not a U.S. real property holding corporation; and

(B) Such corporation is engaged in or is planning to engage in a trade or business of mining, farming, or forestry, or of buying and selling or developing real property, or of leasing real property to tenants.

The supplemental statement must inform the Internal Revenue Service that the corporation meets the criteria of subdivisions (A) and (B) of this paragraph (h)(5)(iii), and must be attached to or incorporated in the statement provided under paragraph (h)(2) or (h)(4) of this section.

(iv) *Corporation determining real property holding corporation status of second corporation.* A corporation that is subject to the requirements of paragraph (h)(2) of this section (or that voluntarily complies with the requirements of paragraph (h)(4) of this section) must submit a supplemental statement to the Internal Revenue Service if such corporation independently determines whether or not an interest in a second corporation is a U.S. real property interest, pursuant to paragraph (g)(2)(iv) of this section. The supplemental statement must set forth that it is made pursuant to this paragraph (h)(5)(iv) and must briefly summarize the facts upon which the corporation's determination is based and the sources of the information relied upon by the

corporation. The supplemental statement must be attached to or incorporated in the statement provided under paragraph (h)(2) or (h)(4) of this section.

(i) *Transition Rules*—(1) *General waiver of penalties for failure to file.* If a foreign person disposed of an interest in a domestic corporation between June 18, 1980 and January 23, 1987, and such person establishes under the rules of paragraph (g) of this section at any time that the interest disposed of was not a U.S. real property interest, then such person shall not be subject to tax under section 897 and shall not be subject to penalties (or interest) for failure to file an income tax return with respect to such disposition.

(2) *Foreign persons that met the requirements of prior regulations.* A foreign person that disposed of an interest in a domestic corporation between June 18, 1980 and January 23, 1987, shall be deemed to have satisfied the requirements of paragraph (g) of this section with respect to such disposition if such person established under prior temporary or prior final regulations issued under section 897 that the interest disposed of was not a U.S. real property interest.

(Sec. 897 (94 Stat. 2683; 26 U.S.C. 897), sec. 6011 (68A Stat. 732; 26 U.S.C. 6011) and sec. 7805 (68A Stat. 917; 26 U.S.C. 7805) of the Internal Revenue Code of 1954)

[T.D. 7999, 49 FR 50702, Dec. 31, 1984; 50 FR 12531, Mar. 29, 1985; T.D. 8113, 51 FR 46627, Dec. 24, 1986; 52 FR 3796, 3916, Feb. 6, 1987; T.D. 9082, 68 FR 46083, Aug. 5, 2003]

§ 1.897-3 Election by foreign corporation to be treated as a domestic corporation under section 897(i).

(a) *Purpose and scope.* This section provides rules pursuant to which a foreign corporation may elect under section 897(i) to be treated as a domestic corporation for purposes of sections 897, 1445, and 6039C and the regulations thereunder. A foreign corporation with respect to which an election under section 897(i) is in effect is subject to all rules under sections 897 and 1445 that apply to domestic corporations. Thus, for example, if a foreign corporation that has made an election under section 897(i) is a U.S. real property holding corporation, interests in it are U.S.

real property interests that are subject to withholding under section 1445, and any gain or loss from the disposition of such interests by a foreign person will be treated as effectively connected with a U.S. trade or business under section 897(a). Similarly, if a foreign corporation makes an election under section 897(i), its distribution of a U.S. real property interest pursuant to section 301 will be subject to the carryover basis rule of section 897(f). However, an interest in an electing corporation is not a U.S. real property interest if following the election the interest is described in section 897(c)(1)(B) or § 1.897-1(c)(2) (subject to the exceptions of subdivisions (i) and (ii) of that section). In addition, section 897(d) will not apply to any distribution of a U.S. real property interest by such corporation or to any sale or exchange of such interest pursuant to a plan of complete liquidation under section 337. A foreign corporation that makes an election under section 897(i) shall not be treated as a domestic corporation for purposes of any other provision of the Code or regulations, except to the extent that it is required to consent to such treatment as a condition to making the election. For further information concerning the effect of an election under section 897(i) upon the withholding requirements of section 1445, see § 1.1445-7. An election under section 897(i) is the exclusive remedy of any foreign person claiming discriminatory treatment under any treaty with respect to the application of sections 897, 1445, and 6039C to a foreign corporation. Therefore, if a corporation does not make an effective election, relief under a non-discrimination article of any treaty shall not be otherwise available with respect to the application of sections 897, 1445, and 6039C to such corporation.

(b) *General conditions.* A foreign corporation may make an election under section 897(i) only if it meets all three of the following conditions.

(1) *Holding a U.S. real property interest.* The foreign corporation must hold a U.S. real property interest at the time of the election. This condition is satisfied when a U.S. real property interest is acquired simultaneously with the effective date of an election. For example, this condition is satisfied