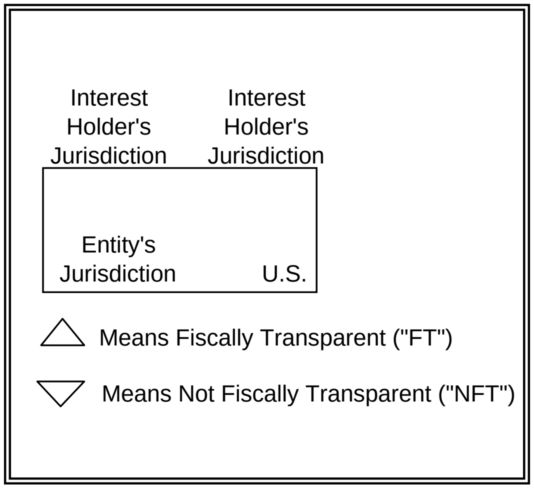
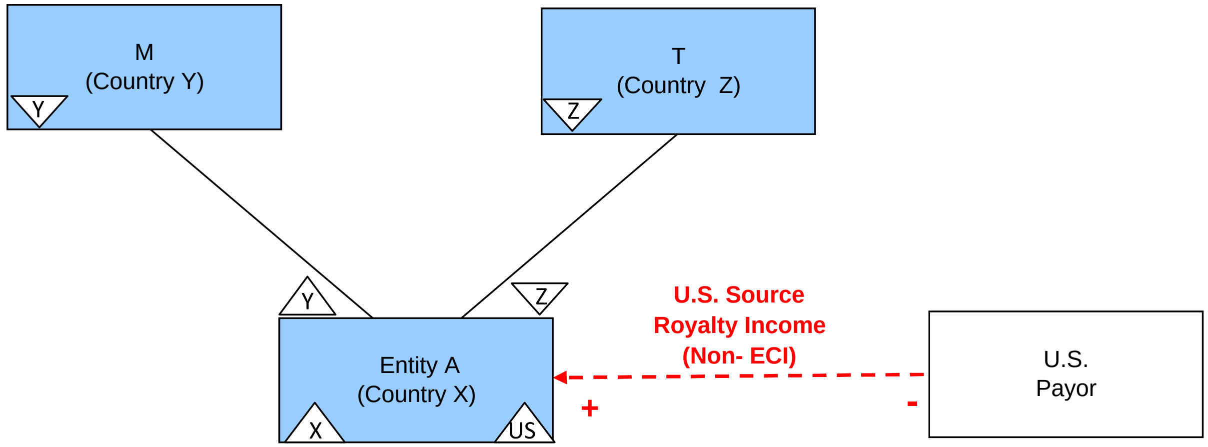
Reg. 1.894-1(d)(5), Example 2

One of Two Interest Holders Eligible for Reduced Treaty Rate

Key to Fiscal Transparency





Entity A is a business organization formed under the laws of Country X that has an income tax treaty in effect with the United States. A is treated as a partnership (FT) for U.S. federal income tax purposes. A is also treated as a partnership (FT) under the laws of Country X. A receives royalty income from U.S. sources that is not effectively connected with the conduct of a trade or business in the United States.

A's partners are M, a corporation organized under the laws of Country Y that has an income tax treaty in effect with the United States, and T, a corporation organized under the laws of Country Z that has an income tax treaty in effect with the United States. M and T are not fiscally transparent (NFT) under the laws of their respective countries of incorporation. Country Y treats A as fiscally transparent. Country Z treats A as a corporation (NFT) and does not require T to take its share of A's income into account on a current basis whether or not distributed.

M is treated as deriving its share of the U.S. source royalty income for purposes of the U.S.-Y income tax treaty because A is fiscally transparent with respect to that income under the laws of Country Y. Under Country Z law, however, because T is not required to take into account its share of the U.S. source royalty income received by A on a current basis whether or not distributed, A is not treated as fiscally transparent. Accordingly, T is not treated as deriving its share of the U.S. source royalty income for purposes of the U.S.-Z income tax treaty.