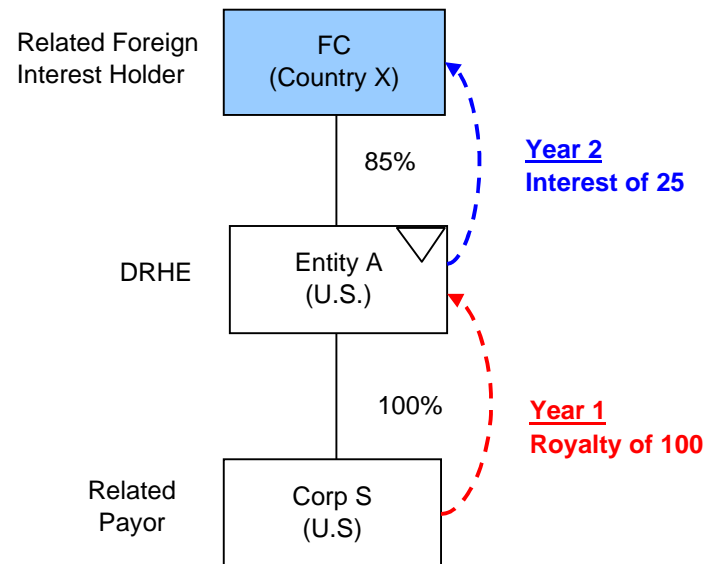


Reg. 1.894-1(d)(2)(iii), Example 9

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Royalty to DRHE & Interest to Foreign Holder



▽ Domestic reverse hybrid entity ("DRHE") - Not fiscally transparent (not "flow-thru") for U.S. tax purposes but fiscally transparent for foreign tax purposes.

The facts are the same as in Example 3, except the \$100 income received by A from S in year 1 is a royalty payment under both the laws of the United States and the laws of Country X. The royalty rate under the treaty is 10% and the interest rate is 0%. The analysis as to the royalty payment from S to A is the same as in Example 1 with respect to the \$100 dividend payment from S to A. The \$25 interest payment from A to FC will not be recharacterized as a dividend because the payment from S to A is not a dividend.

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