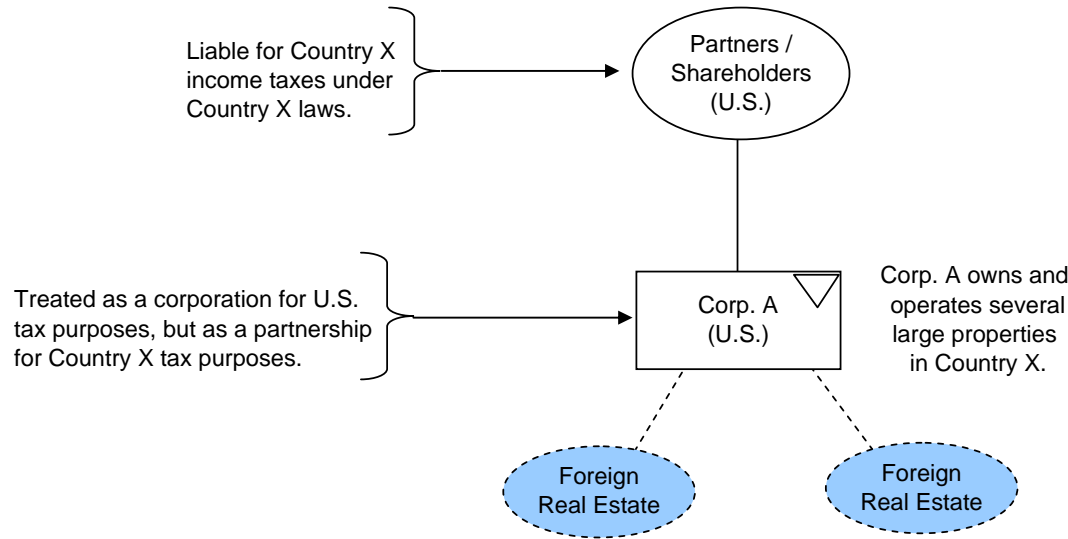


"Shareholders" Liable for Foreign Taxes of Reverse Hybrid Entity



Corp. A is a "reverse hybrid" entity because it is treated as a flow-thru (partnership) for foreign tax purposes, but it is treated as a corporation for U.S. tax purposes.

Section 901 allows a credit against Federal income tax (subject to certain limitations) for the amount of foreign income taxes paid by the taxpayer. In certain circumstances, such as those above, it may be unclear "who" the taxpayer is -- the shareholders or the corporation. A foreign tax paid is "creditable" only if the taxpayer is legally liable under foreign law for payment of the tax. See Reg. 1.901-2(f)(1).

In the above circumstances, foreign law treats the partners/shareholders as being liable for the tax. Therefore, it is the partners/shareholders that are entitled to claim the foreign tax credit. Corp. A cannot claim as a foreign tax credit any of the foreign taxes paid.

Note that this type of structure can create some severe distortions of the foreign tax credit limitation under section 904 -- all of the foreign source income is recognized by Corp. A, but all of the foreign tax credits are creditable to the partners/shareholders.

▽ Means "flow-thru" for foreign tax purposes, but treated as a corporation for U.S. tax purposes (i.e., a "reverse hybrid" entity).