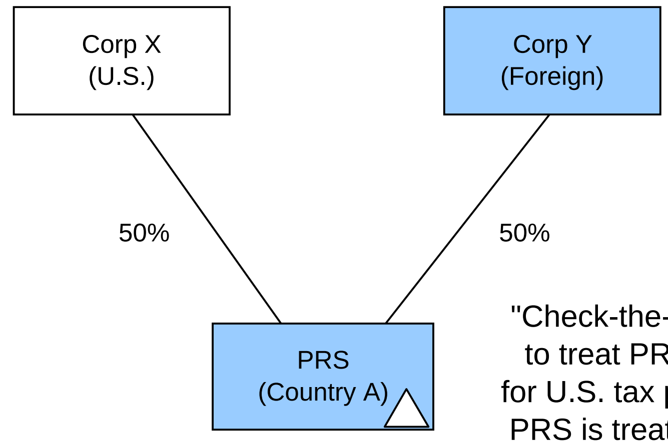
Reg. 1.701-2(d), Example 3

Check-the-Box Planning to Get 901 Credits and to Avoid 10/50 Basket



"Check-the-Box" election made to treat PRS as a partnership for U.S. tax purposes. However, PRS is treated as a corporation for County A tax purposes.

△ means flow-thru for U.S. tax purposes

X, a domestic corporation, and Y, a foreign corporation, form PRS under the laws of foreign Country A to conduct a bona fide joint business. X and Y each owns a 50% interest in PRS. PRS is properly classified as a partnership under §§301.7701-2 and 301.7701-3. PRS pays income taxes to Country A. X and Y chose partnership form to enable X to qualify for a direct foreign tax credit under section 901, with look-through treatment under §1.904-5(h)(1). Conversely, if PRS were a foreign corporation for U.S. tax purposes, X would be entitled only to indirect foreign tax credits under section 902 with respect to dividend distributions from PRS. The look-through rules, however, would not apply, and pursuant to section 904(d)(1)(E) and §1.904-4(g), the dividends and associated taxes would be subject to a separate foreign tax credit limitation for dividends from PRS, a noncontrolled section 902 corporation.

[The foreign tax credit baskets and look-through rules have been changed since this example was promulgated. However, the example is important in that the regulations explicitly condone the use of entity classification manipulation for purposes of foreign tax credit planning.]