The facts are the same as in Example 3, except that A has two 50-percent shareholders, FC1 and FC2 and FP owns 100% of both FC1 and FC2. FP is organized under the laws of Country X. In year 2, A makes an interest payment of $25 to both FC1 and FC2. Country X and Country Y have income tax treaties in effect with the United States. Under Country X law, FC1 is not fiscally transparent, but A is fiscally transparent. Under Country Y law, neither FC2 nor A are fiscally transparent. The analysis is the same as in Example 1 with respect to the $100 dividend payment from S to A.

With respect to the $25 payment in year 2 by A to FC1, the payment will be treated as a dividend to the extent the payment does not exceed FC1’s share of the dividend payment made by S to A ($50). FC1 is a related foreign interest holder because FC1 is treated as owning the stock of A owned by FC2 under section 267(b)(3). FC1 is entitled to the 5-percent reduced rate applicable to dividends under the U.S.-Country X income tax treaty. A is not entitled to an interest deduction with respect to the $25 payment to FC1. Although FC2 is a related foreign interest holder, the $25 interest payment by A to FC2 in year 2 is not recharacterized because A is not fiscally transparent under the laws of Country Y.