The facts are the same as in Example 3, except that under the U.S.-Country X income tax treaty, the rate of tax on interest is 10% and the rate of tax on dividends is 5%. The analysis is the same as in Example 1 with respect to the $100 dividend payment from S to A. The analysis is the same as in Example 3 with respect to the $25 interest payment in year 2 from A to FC.

Thus, FC will benefit from the lower withholding tax rate on dividends as a result of the recharacterization of the interest to dividends. However, the interest deduction to A will still be lost.

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