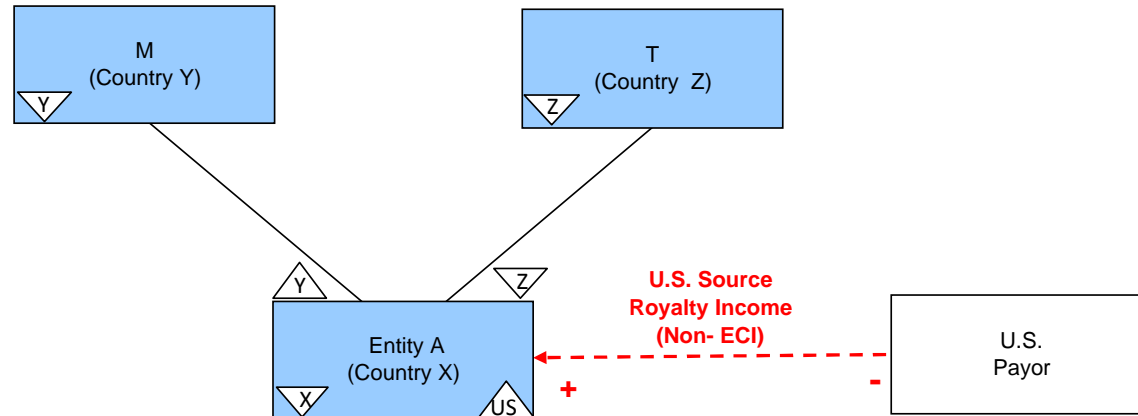
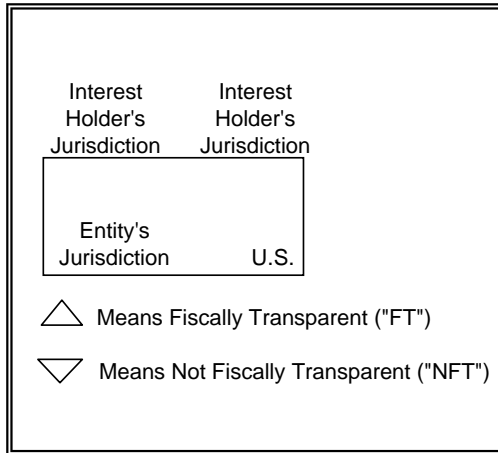


**Reg. 1.894-1(d)(5), Example 3**

**Entity & Interest Holder Eligible for Reduced Treaty Rate**

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**Key to Fiscal Transparency**



Entity A is a business organization formed under the laws of Country X that has an income tax treaty in effect with the United States. A is treated as a partnership (FT) for U.S. federal income tax purposes. A is treated as a corporation (NFT) under the laws of Country X. A receives royalty income from U.S. sources that is not effectively connected with the conduct of a trade or business in the United States. A's partners are M, a corporation organized under the laws of Country Y that has an income tax treaty in effect with the United States, and T, a corporation organized under the laws of Country Z that has an income tax treaty in effect with the United States. M and T are not fiscally transparent (NFT) under the laws of their respective countries of incorporation. Country Y treats A as fiscally transparent. Country Z treats A as a corporation (NFT) and does not require T to take its share of A's income into account on a current basis whether or not distributed. The U.S.-X income tax treaty provides for a source country reduced rate of taxation on royalties of 5-percent. The U.S.-Y income tax treaty provides that royalty income may only be taxed by the beneficial owner's country of residence.

A is treated as deriving the U.S. source royalty income for purposes of the U.S.-X income tax treaty because it is not fiscally transparent with respect to the item of income in Country X, its country of organization. M is also treated as deriving its share of the U.S. source royalty income for purposes of the U.S.-Y income tax treaty because A is fiscally transparent with respect to that income under the laws of Country Y. T is not treated as deriving the U.S. source royalty income for purposes of the U.S.-Z income tax treaty because under Country Z law A is not fiscally transparent. Assuming all other requirements for eligibility for treaty benefits have been satisfied, A is entitled to the 5-percent treaty reduced rate on royalties under the U.S.-X income tax treaty with respect to the entire royalty payment. Assuming all other requirements for treaty benefits have been satisfied, M is also entitled to a zero rate under the U.S.-Y income tax treaty with respect to its share of the royalty income.

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