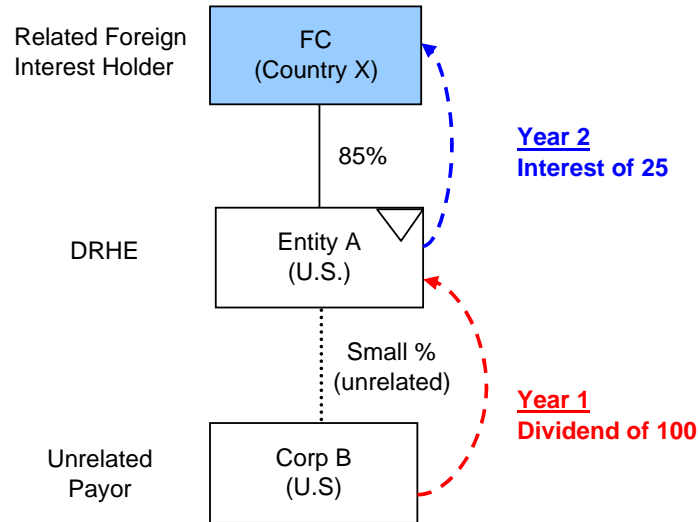


Reg. 1.894-1(d)(2)(iii), Example 2

**Interest Paid by DRHE to  
Related Foreign Interest Holder**



▽ Domestic reverse hybrid entity ("DRHE") - Not fiscally transparent (not "flow-thru") for U.S. tax purposes but fiscally transparent for foreign tax purposes.

The facts are the same as in Example 1. In addition, in year 2, A makes a payment of \$25 to FC that is characterized under the Internal Revenue Code as interest on a loan from FC to A. Under the U.S.-Country X income tax treaty, the rate of tax on interest is zero. Under Country X law, FC is not fiscally transparent. Because A is not related to B, the \$25 of interest paid by A to FC in year 2 is characterized under U.S. law as interest. Accordingly, in year 2, A is entitled to an interest deduction with respect to the \$25 interest payment from A to FC, and FC is entitled to the reduced rate of withholding applicable to interest under the U.S.-Country X income tax treaty, assuming all other requirements for claiming treaty benefits are met.

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