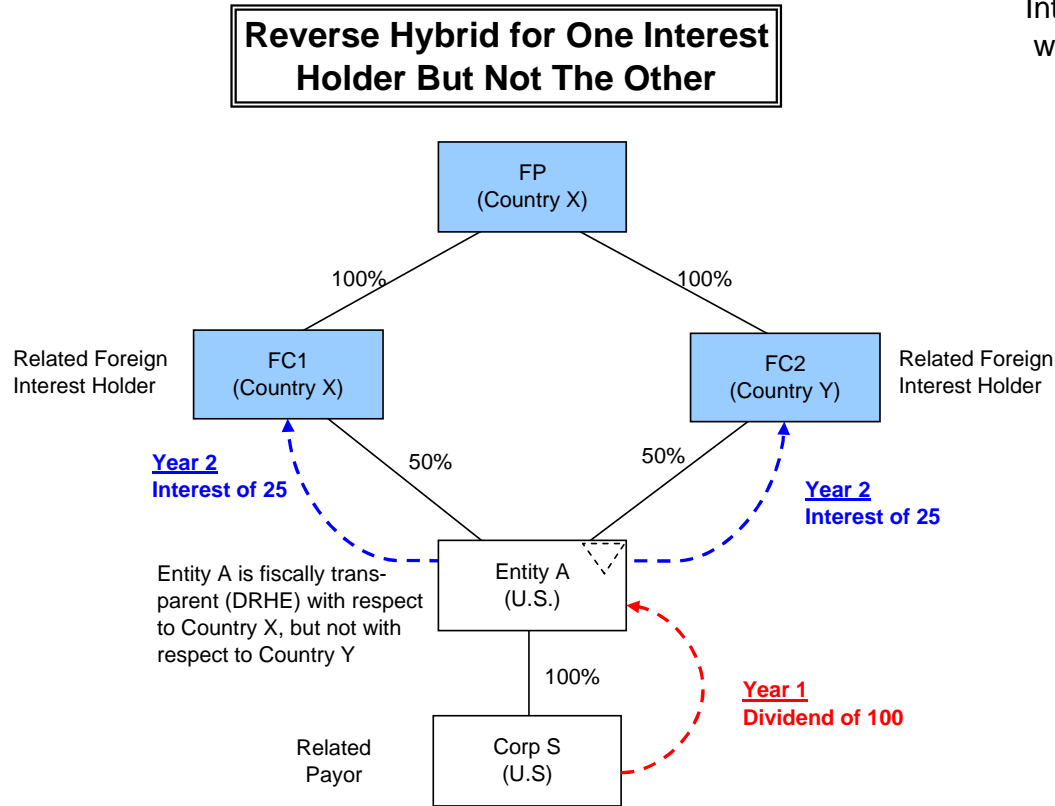


Reg. 1.894-1(d)(2)(iii), Example 4

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▽ Domestic Reverse Hybrid Entity ("DRHE") for one interest holder (FC1) but not the other interest holder (FC2).

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.

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