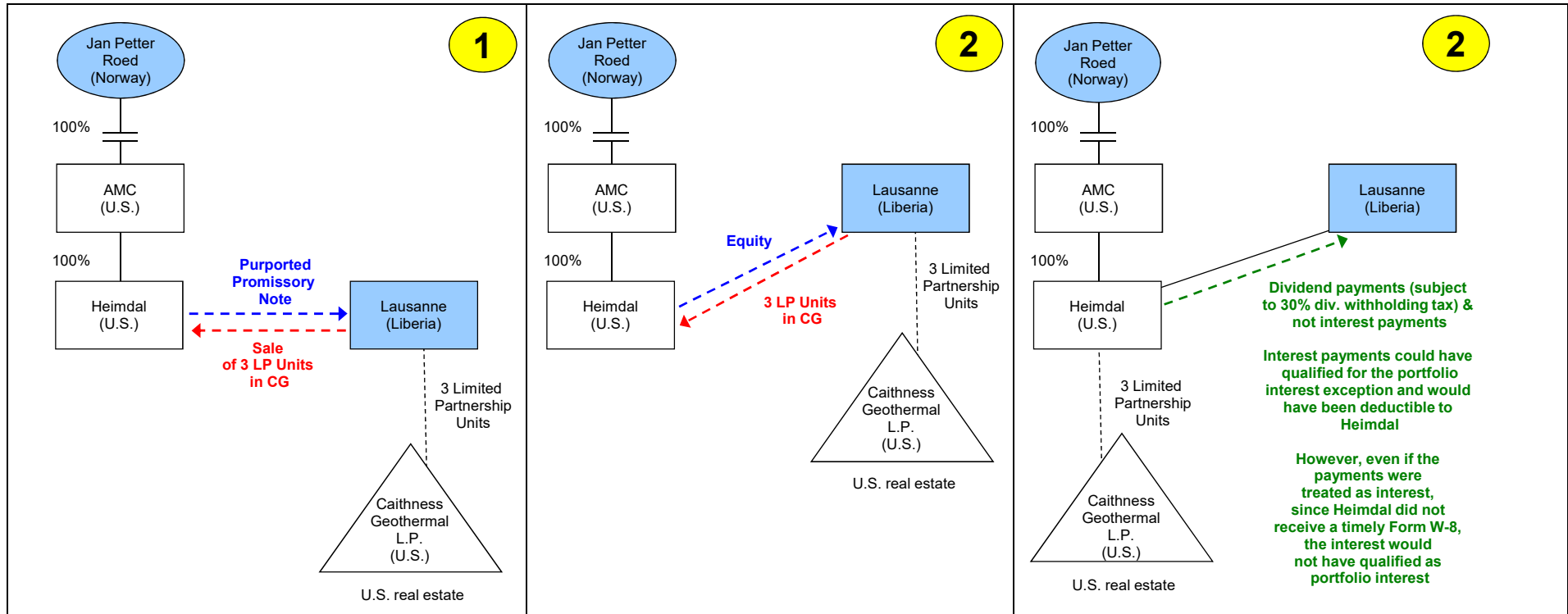


**Taxpayer Position:  
Sale for Installment Note**

**Court Held:  
Exchange for Equity**

**Characterization of  
Post-Transfer Payments**



Lausanne, a Liberia corporation, owned 3 limited partnership units in Caithness Geothermal L.P. ("CG"), a U.S. limited partnership. Lausanne was subject to both U.S. corporate income tax and U.S. branch profits tax on the profits flowing up from CG. Lausanne transferred ownership of its 3 limited partnership units to Heimdal, a U.S. corporation, in exchange for an instrument that was purportedly debt.

The Tax Court held that the instrument was not debt, but instead was equity. Thus, when Heimdal made "interest" and "principal" payments to Lausanne, they were treated as dividends and were subject to U.S. dividend withholding tax of 30%.

If the instrument were characterized as debt, Heimdal would have had interest deductions and the interest paid may have qualified as portfolio interest, which is not subject to the 30% U.S. withholding tax. However, even if the instrument had been characterized as debt, at least for some years Heimdal did not receive a timely Form W-8 from Lausanne. Thus, the interest would not have qualified for the portfolio interest exception for those years.