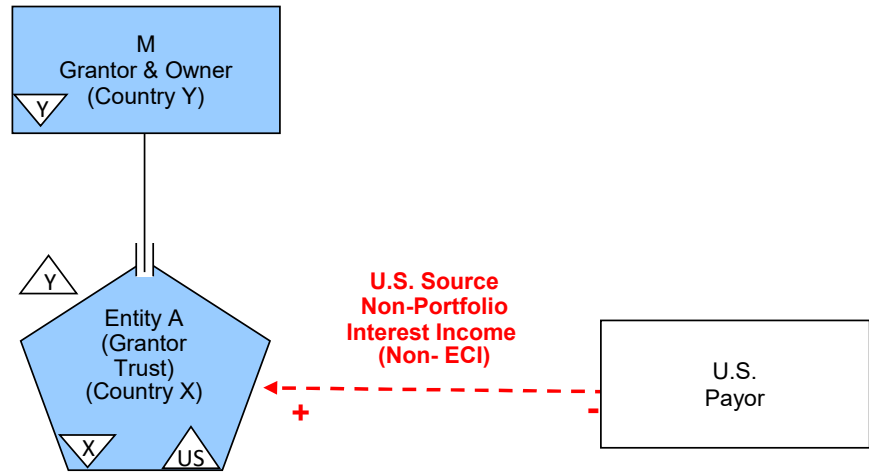
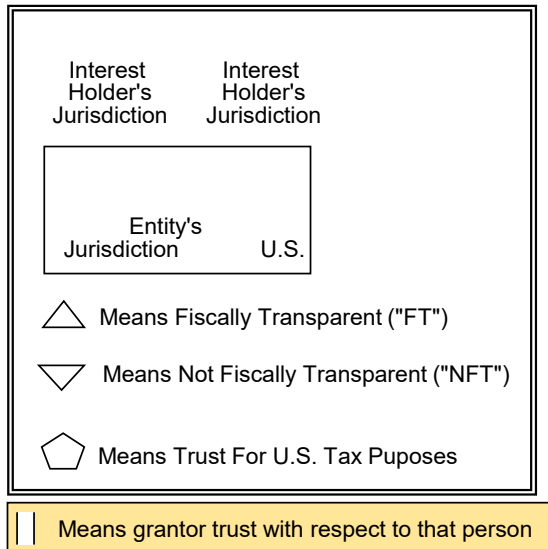


**Reg. 1.894-1(d)(5), Example 4**

**Foreign Grantor of Foreign Grantor Trust Eligible For Reduced Treaty Rate**

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**Key to Fiscal Transparency**



Entity A is a trust organized under the laws of Country X, which does not have an income tax treaty in effect with the United States. M, the grantor and owner of A for U.S. income tax purposes, is a resident of Country Y, which has an income tax treaty in effect with the United States. M is also treated as the grantor and owner of the trust under the laws of Country Y. Thus, Country Y requires M to take into account all items of A's income in the taxable year, whether or not distributed to M, and determines the character of each item in M's hands as if such item was realized directly from the source from which realized by A. Country X does not treat M as the owner of A and does not require M to account for A's income on a current basis whether or not distributed to M. A receives interest income from U.S. sources that is neither portfolio interest nor effectively connected with the conduct of a trade or business in the United States.

A is not fiscally transparent under the laws of Country X with respect to the U.S. source interest income, but A may not claim treaty benefits because there is no U.S.-X income tax treaty. M, however, does derive the income for purposes of the U.S.-Y income tax treaty because under the laws of Country Y, A is fiscally transparent.