



### The Adaptation of United States Tax Treaties to Changing Business Forms—A Case Study of Hybrid Entities

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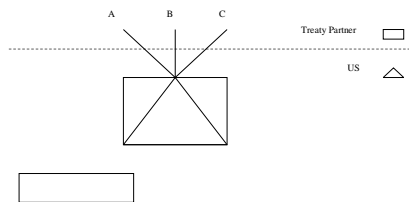


### Check-the-Box Regulations

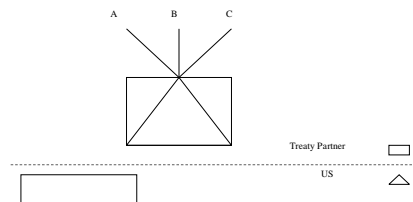
- 1997 Adoption of Regulations
- In foreign context, any enterprise other than 80 plus specified business forms in particular countries (e.g., Public Limited Company in India) can elect either partnership/ transparent treatment or corporate/ opaque treatment for tax purposes
- Leads to four types of hybrid entities—domestic regular hybrid, foreign regular hybrid, domestic reverse hybrid, and foreign reverse hybrid



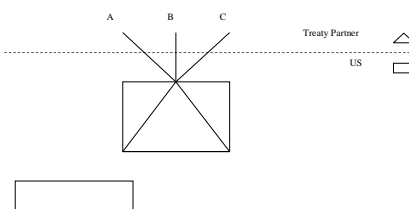
### Domestic Regular Hybrid Entity



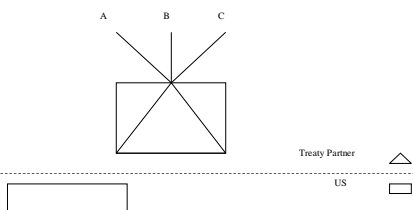
### Foreign Regular Hybrid Entity



### Domestic Reverse Hybrid Entity



### Foreign Reverse Hybrid Entity



### Treaty Treatment of Partnerships—Older Treaties

- Older Treaties, e.g., India, “In the case of income derived...by a partnership..., this term applies only to the extent that the income...is subject to tax in that State as the income of a resident, either in its hands or in the hands of its partners...”
- Interpretive issues—applicability to limited liability companies, hybrid entities, passive income, active income?

### Treaty Treatment of Partnerships—More Modern Treaties

- More modern treaties, e.g., Thailand, “An item of income...derived through a person that is fiscally transparent under the laws of either Contracting State shall be considered to be derived by a resident...to the extent that the item is treated for the purposes of the taxation law of such Contracting State as the income...of a resident.”
- Interpretive issues—applicability to hybrid entities, active income, passive income?

### Response of United States to Uncertainty—Code and Regulation

- Code §894(c) enacted and Regulation § 1.894-1(d) promulgated providing: “The tax...on an item of income received by an entity...that is fiscally transparent...shall be eligible for reduction...of an income tax treaty [of the United States] only if the item of income is derived by a resident [entity or interest holder] of the applicable treaty jurisdiction.”
- Accordingly, depending upon the tax laws of the jurisdiction(s) of residence of the entity and its members, treaty benefits may be available to the entity only, the members only, both the entity and its members, or neither the entity nor its members.

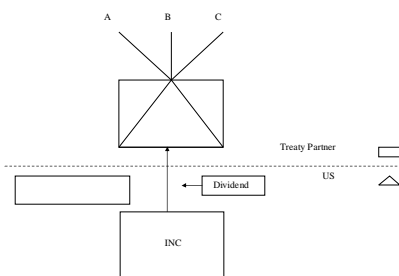
### Response of United States to Uncertainty—Code and Regulation cont'd

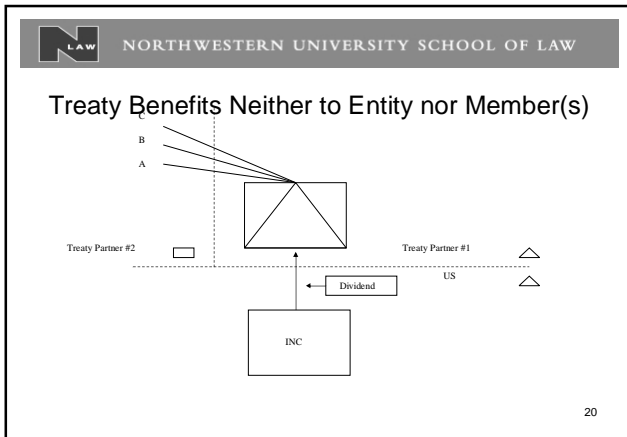
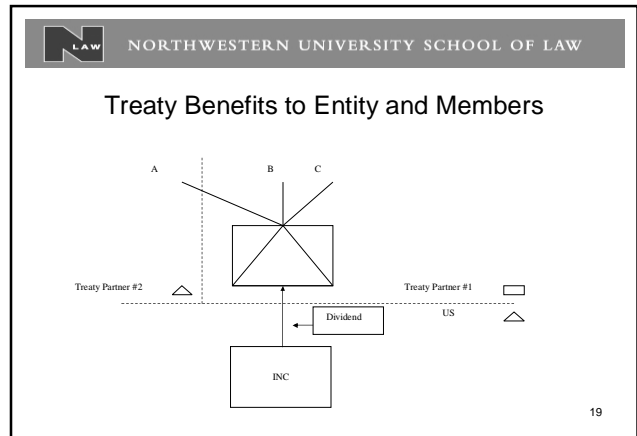
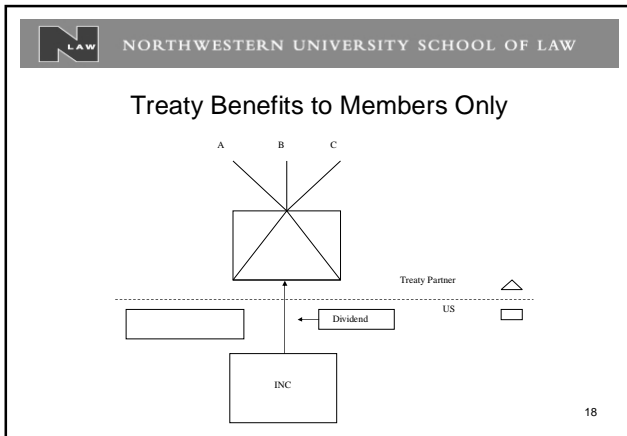
- Limited to passive income.
- Unless otherwise provided in the treaty’s text, these rules apply to all tax treaties of the United States, provided reciprocal treatment, Reg. § 1.894-1(d)(4).

### Clarification of Treaty Applicability

- Technical Explanations, e.g., Latvia, clarifying extension to limited liability companies, and e.g., Belgium, clarifying extension to hybrid entities.
- Competent Authority Agreement, e.g., Mexico, clarifying extension to hybrid entities.

### Treaty Benefits to Entity Only





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- ### Post Check-the-Box Treaties—Express Coverage
- Japan, Article 4, paragraph 6 specifically addresses hybrid structures.
  - Subparagraph (a)—if Japanese hybrid entity transparent under Japanese law, members resident in Japan can claim treaty benefits.
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- ### Post Check-the-Box Treaties—Express Coverage
- Subparagraph (b)—if Japanese hybrid entity non-transparent under Japanese law, entity can claim benefits if taxed under Japanese law.
  - Subparagraph (c)—if third country hybrid entity treated as fiscally transparent by Japan and has resident members, members can claim treaty benefits.
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- ### Post Check the Box Treaties—Express Coverage cont'd
- Subparagraph (d)—if third country hybrid entity treated as non-transparent by Japan, Japanese residents are not entitled to treaty benefits.
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### Post Check the Box Treaties—Express Coverage cont'd

- Subparagraph (e)—if United States hybrid entity derives income which is taxable by the United States, no treaty benefits are available to Japanese members even if Japan treats entity as transparent. Confirms governance of saving clause.
- Saving clause, Japan, Article I, paragraph 4(a): “this Convention shall not affect the taxation by a Contracting State of its residents (as determined under Article 4) and, in the case of the United States, its citizens.”