The Adaptation of U.S. Tax Treaties to Changing Business Forms– A Case Study of Hybrid Entities

*By Philip F. Postlewaite, Stephanie R. Hoffer and Matthew T. Kemp**

Philip F. Postlewaite is the Harry Horrow Professor in International Law, Northwestern University School of Law. **Stephanie R. Hoffer** is an Assistant Professor of Law, Ohio State University, Moritz College of Law. **Matthew T. Kemp** is a law student at Northwestern University School of Law (expected J.D. 2009).

I. Introduction

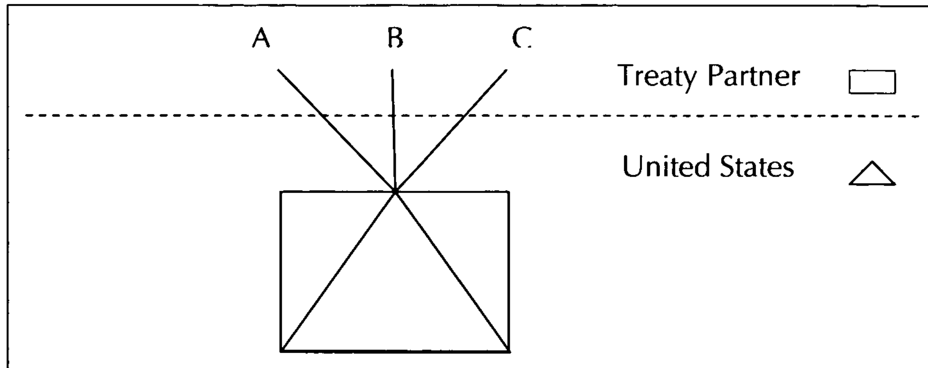
Hybrid business entities—treated as conduits that are fiscally transparent in one country but as separate entities that are fiscally opaque in another—create challenges of treaty interpretation when their income crosses international borders. The basic difficulty in such cases is that the countries of source and residence disagree on whether the entity itself or its members are taxable on such income. Accordingly, with regard to treaty benefits, this divergent treatment may lead to double taxation or double nontaxation. The extensive network of bilateral tax treaties entered into by the United States, almost without exception, addresses partnerships and other transparent entities. Only recently has the language of the treaties begun to deal explicitly with issues generated by hybrid entities.

The current popularity of hybrid entities is due largely to the "check-the-box" (C-T-B) regulations[1] adopted by the United States a decade ago. They provide a relatively easy method for creating hybrid structures.[2] Under the C-T-B regulations, an entity that is engaged in business and not a *per se* corporation is an "eligible entity." A *per se* corporation under the regulations includes any domestic enterprise that has incorporated under state or federal law and any foreign entity enumerated in the regulations in 80 specified foreign jurisdictions.[3]

An eligible entity with two or more members may elect to be classified and taxed either as a partnership or as an association taxable as a corporation.[4] Such an entity with only one member may elect to be classified as an association taxable as a corporation or to be disregarded and taxed to its owner as a sole

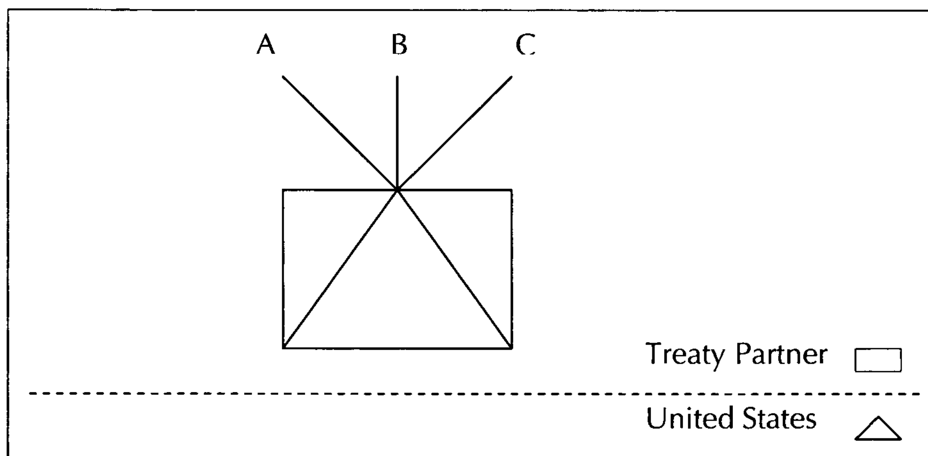
©2008 P.F. Postlewaite, S.R. Hoffer and M.T. Kemp

Diagram 1. Domestic Regular Hybrid



transparent by the foreign treaty partner) (*see* Diagram 3); and (4) a foreign reverse hybrid entity (formed outside the United States, treated as a separate entity by the United States and as transparent by the foreign treaty partner) (*see* Diagram 4). In each of the diagrams above, a triangle represents a transparent entity, and a rectangle represents an opaque entity.

Diagram 2. Foreign Regular Hybrid



proprietor or as a branch.[5] In either case, the owners of an electing entity may obtain a single level of tax rather than the two-level tax of the corporation/shareholder format.[6] If the entity does not make an affirmative election as to its tax classification, its tax classification is determined under default provisions.[7] The default provisions basically favor noncorporate classification in the domestic context and corporate classification in the foreign context.

Under these rules, there are four logical hybrid structures from the perspective of the United States that can arise: (1) a domestic regular hybrid entity (formed in the United States, treated as a transparent partnership by the United States and as an opaque, separate entity by the foreign treaty partner) (*see* Diagram 1); (2) a foreign regular hybrid entity (formed outside the United States, treated as transparent by the United States and as opaque by the foreign treaty partner) (*see* Diagram 2); (3) a domestic reverse hybrid entity (formed in the United States, treated as a separate entity by the United States but as transparent by the foreign treaty partner) (*see* Diagram 3); and (4) a foreign reverse hybrid entity (formed outside the United States, treated as a separate entity by the United States and as transparent by the foreign treaty partner) (*see* Diagram 4).

This article will examine the distinct approaches that the United States has taken when determining the treaty eligibility of the four categories of hybrid entities described above. Part II will consider these approaches in general terms and will compare them with positions adopted in the OECD model commentary and the recently adopted United States Model Treaty. Part III will present a more detailed description of the four approaches, as well as a description of the Code Sec. 894 regulations applicable to hybrid entities. Part IV will provide working examples of each approach as typified by the U.S.-Barbados treaty, the U.S.-United Kingdom treaty, the U.S.-Japan and the U.S.-Canada treaty. Part V will conclude that while U.S. tax treatment of hybrid entities has become clearer and more effective in recent years, there is still room for improvement. Treaty language could provide a greater level of detail, and the harmonization of hybrid entity provisions across treaties would provide additional certainty to both domestic and foreign investors.

II. Regulatory and Model Approaches to Treaty Eligibility of Hybrid Entities

The general approach of the United States to hybrid entities is captured in the Code Sec. 894 regulations. As hybrid entities began to proliferate, the IRS and the Treasury addressed the issue of treaty benefits for passive income through the introduction of specific

Diagram 3. Domestic Reverse Hybrid

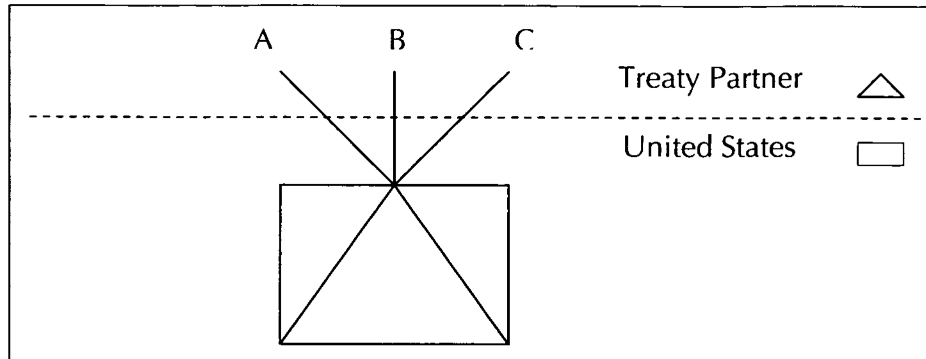
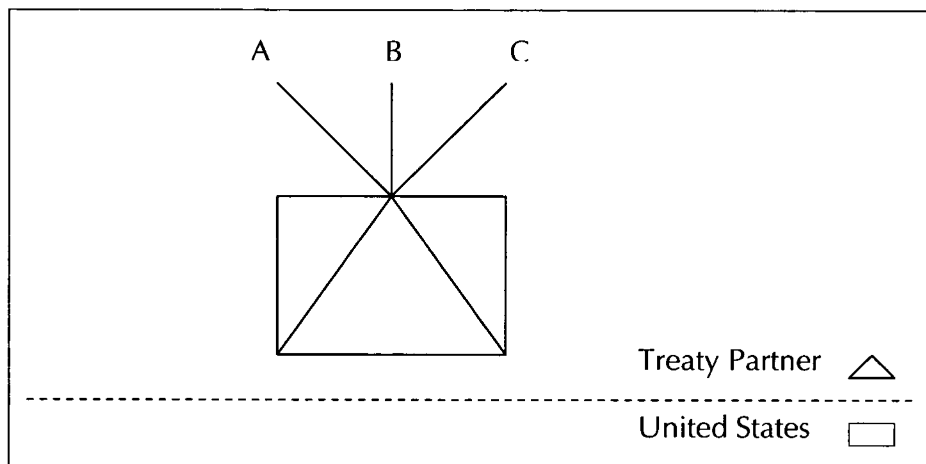


Diagram 4. Foreign Reverse Hybrid



rules in the regulations. As it frequently takes years to renegotiate a tax treaty or to enter a protocol, the regulations offered a quick solution, provided that the foreign taxpayer or his legal advisor was aware of their existence and of the pro-taxpayer results that they typically generate. Unfortunately, this unilateral approach is of little value to domestic taxpayers engaged in passive foreign investment through hybrid structures because the availability of the Code Sec. 894 regulations is conditioned upon the treaty partner affording similar treatment.[8] Although the regulations presume reciprocity in the absence of a public notice or mutual agreement with the treaty partner, there is no time limitation upon the treaty partner's actions in this regard.[9] In other words, investors cannot rely upon the lack of such a notice, as one may come at any time. The regulations specify that once the IRS has alerted taxpayers to a lack of reciprocity, the treaty benefits formerly ensured by the regulations will be denied.[10] This limitation upon the applicability of the regulations introduces both uncertainty and inefficiency into the already chaotic environment of international investment. Although the tax policy trajectories of some foreign treaty partners are clear, it goes without saying that others are not. In those instances, the Code Sec. 894 regulations may provide little comfort.

The general rule advanced by the regulations is that an entity organized in a foreign country can only claim treaty benefits on the receipt of U.S.-source passive income if the entity is considered a "resident" of that country for tax purposes (*i.e.*, the entity is *not* transparent). If the entity is treated as transparent by that country, its members may claim treaty benefits if they are subject to tax on that income as "residents" of the foreign treaty partner. The tax laws of the state in which the entities or members claiming treaty benefits reside are controlling, even though the income is sourced in the United States.

The regulations are generally in accord with the approach taken by the U.S. Model Treaty and the OECD Model Treaty and Commentary.[11] As a matter of outcomes, the OECD and the United States have adopted similar approaches to the question of hybrid entities. The OECD's 1999 Partnership Report addressed the problems of double taxation and double nontaxation arising from two sources: different classifications given to the same entity by the states of source and residence, and different tax treatment given by the states of source and residence despite similar classification of the entity in question.[12] Rather than approach the problem of hybrid entities as one requiring additional treaty drafting in the wake of the U.S. C-T-B regulations, the OECD chose an interpretive approach. In accordance with the Partnership Report, it revised the Model Treaty Commentary, but it did not add or remove provisions from the Model Treaty itself.

The OECD Report observed that eligibility for treaty benefits under Article One of the Model Treaty depends upon residence in one of the con-

tracting states.[13] Residence, in turn, is described by Article Four, which provides that a resident is a person who is liable for tax in a contracting state by reason of domicile, residence, place of management or similar criteria.[14] The Report reasoned that if the state of residence views an entity as fiscally transparent, the entity is not liable for tax and therefore cannot be a resident for purposes of Article 4. In other words, whether a source state affords treaty benefits to an entity is determined with reference to the residence state's characterization of the entity.[15] The source state's characterization is irrelevant; therefore, applicability of the Model Treaty to hybrid entities is unambiguous.

The U.S. approach produces an identical result in almost all instances, but rather than merely relying upon an updated interpretation of existing treaties, the United States has recently sought to solidify its position within the language of the treaties themselves.[16] Article 1, clause 6 of the U.S. Model Treaty provides the following:

> An item of income, profit or gain derived through an entity that is fiscally transparent under the laws of either Contracting State shall be considered to be derived by a resident of a State to the extent that the item is treated for purposes of the taxation law of such Contracting State as the income, profit or gain of a resident.[17]

In other words, like the OECD commentary, the U.S. Model Treaty provision looks to the characterization of the state of residence when determining the treaty eligibility of hybrid entities. Similar language has been incorporated into a number of existing U.S. conventions, including but not limited to recent agreements with Denmark, Finland, Germany, Belgium and Sweden.[18]

Unlike the new Model Treaty, the partnership provisions of most older bilateral tax treaties,[19] *i.e.*, those predating the C-T-B regulations, are arguably uncertain in their application. Given the dearth of hybrid structures when these treaties were entered into, it is difficult, if not impossible, to intuit how the treaty drafters would have applied the partnership and corporate provisions of the treaty to current, more advanced business structures.[20] More modern treaties depart slightly from the older treaties with new textual language that appears to expand the scope of the provision beyond traditional partnerships, *i.e.*, to limited liability companies and the like. This expanded scope is more susceptible to application to hybrid structures. In addition, some of the accompanying Technical Explanations to these treaties contain text and examples dealing explicitly with hybrid entities.[21] Finally, given the omnipresence of hybrid structures, treaties in recent years have adopted the Model approach and now possess actual text that clearly addresses tax issues arising in the hybrid context.

U.S. tax treaties can be grouped into four main categories with regard to their application to hybrid entities, each of which is described below. Three of them embrace the rule that the tax laws of the country of residence control the determination of treaty eligibility. These three categories are illustrated by the U.S. tax treaties with Barbados ("partnerships"), the United Kingdom ("person that is fiscally transparent") and Japan ("without regard to whether the income is treated as the income of such ... members ... under the tax laws of the first mentioned Contracting State"), respectively. The U.S.-Barbados treaty illustrates the partnership language found mainly in older treaties. The more modern U.S.-United Kingdom treaty adheres to the principles of the traditional approach, but the wording of the text is broadened through the use of the term "fiscally transparent" entities, which includes passthrough entities such as limited liability companies. The U.S.-Japan tax treaty contains a detailed provision addressing hybrid entities specifically, by prescribing precise rules for the determination of whether and when an income item is eligible for treaty benefits when the transaction involves a hybrid entity. The fourth category, which may deny treaty benefits to persons who receive income from hybrid entity payors, is exemplified by a recent and unique Protocol to the U.S.-Canada treaty.[22]

> The general rule advanced by the regulations is that an entity organized in a foreign country can only claim treaty benefits on the receipt of U.S.-source passive income if the entity is considered a "resident" of that country for tax purposes (*i.e.*, the entity is *not* transparent).

Despite the variant language employed by the Code Sec. 894 regulations, Barbados, United

Kingdom and Japan approaches to the issue, each approach shares an underlying premise: either the entity or its members must be taxable residents of a treaty country before an item of income will be eligible for treaty benefits. It is worth noting, though, that while these differing approaches should be interpreted consistently when applied to varying hybrid entity scenarios, the lack of specificity in older treaties, such as the Barbados treaty, produces less than perfect certainty. Finally, one other feature shared by the Code Sec. 894 regulations and all U.S. tax treaties is the preservation of a country's right to tax its own residents or citizens notwithstanding other regulations or other provisions of the treaty.[23] This right is lodged in the Saving Clause of the applicable treaty. In the case of domestic reverse hybrid entities, the Saving Clause denies otherwise allowable claims for treaty benefits.

III. Types of Hybrid Entity Provisions

1. Code Sec. 894 Regulations

The Code Sec. 894 regulations outline the general rule that passive income received by a transparent entity is eligible for treaty benefits only if the entity or its members are considered residents of a country that is party to a tax treaty. They instruct:

> The tax imposed ... on an item of income received by an entity, wherever organized, that is fiscally transparent under the laws of the United States and/or any other jurisdiction with respect to an item of income shall be eligible for reduction under the terms of an income tax treaty to which the United States is a party only if the item of income is derived by a resident of the applicable treaty jurisdiction.[24]

If the country of residence treats the entity as transparent, the members, if resident therein, will be eligible for treaty benefits. If the members are nonresidents, the income is ineligible for the benefits of the treaty with that particular country (although it may be eligible for the benefits of a different treaty). The regulations are applicable in any treaty context unless the treaty specifically addresses hybrid entities and provides for different treatment.[25]

As the Preamble to the regulations recognizes, the concept of fiscal transparency "is critical to the determination of whether an item of income is derived by an entity or an interest holder in an entity."[26] Accordingly, paragraph (d)(3)(ii) of the regulations determines whether an entity is fiscally transparent in the entity's jurisdiction, and paragraph (d)(3)(iii) determines whether the entity is fiscally transparent in the interest holder's jurisdiction. The entity jurisdiction rule of (d)(3)(ii) applies to any "person" that is not treated as an individual by either treaty jurisdiction, including disregarded entities.[27] The rule specifies that an entity is fiscally transparent with respect to an item of income if the laws of the entity's jurisdiction require its interest holders to account for the income item separately, whether or not it is distributed.[28] In addition, an entity will not be transparent with respect to an item of income under the regulations unless the entity's jurisdiction characterizes the item of income as though the interest holders derived it directly from the payor.[29] Furthermore, an entity will only be considered to be fiscally transparent in the interest holder's jurisdiction with respect to an item of income if the jurisdiction characterizes the item as though it were derived by the interest holder.[30] For purposes of this determination, "it is irrelevant how the entity is treated under the laws of the entity's jurisdiction."[31] These definitions are crucial to the operation of the regulations: entities that are fiscally transparent are not entitled to treaty benefits, but their non-transparent interest holders may be.[32]

The regulations provide different treatment for domestic reverse hybrid entities, *i.e.,* organized in the United States, considered fiscally opaque by the United States, but treated as transparent by another country:

> An income tax treaty may not apply to reduce the amount of federal income tax on U.S. source payments received by a domestic reverse hybrid entity. Further, notwithstanding paragraph (d)(1) of this section, the foreign interest holders of a domestic reverse hybrid entity are not entitled to the benefits of a reduction of U.S. income tax under an income tax treaty on items of income received from U.S. sources by such entity.[33]

Thus, even though the treaty partner country may tax the income to its resident beneficiaries, the United States is not required to grant treaty benefits. This is because the entity is a taxable U.S. corporation.

The Code Sec. 894 regulations relate only to passive income, *i.e.,* "U.S. source income that is not effec-

tively connected with the conduct of a U.S. trade or business."[34] They do not address business profits. The Preamble to the regulations fails to provide an explanation for this limitation. The IRS and the Treasury have seemingly decided to postpone the resolution of the issue and to deal separately with this matter at the appropriate time.

2. Traditional "Partnership" Language: U.S.-Barbados Treaty

Most older tax treaties do not explicitly address hybrid entities. The U.S.-Barbados treaty contains a "partnership" provision, typifying the language used in the residency article of older treaties.[35] It specifies that a "partnership, estate or trust" is a resident of the United States "only to the extent that the income derived by such partnership, estate or trust is subject to United States tax as income of a resident, either in its hands or in the hands of its partners or beneficiaries."[36] The treaty is silent with regard to other transparent or hybrid entities. It is a near certainty that the older treaties, such as the Barbados treaty, did not contemplate the problems posed by hybrid entities as they were entered prior to the promulgation of the C-T-B regulations. However, by linking treaty benefits to residency requirements, these partnership provisions appear to reach the same result as the Code Sec. 894 regulations.

Under the U.S.-Barbados treaty, in order for an entity to claim benefits on U.S. source income, the taxpayer must be a resident "subject to tax" in Barbados; therefore, it cannot be fiscally transparent. If the entity *is* fiscally transparent, its members can only claim treaty benefits if *they* are residents "subject to tax" in Barbados. This is precisely the outcome that occurs under the Code Sec. 894 regulations. The Barbados treaty does not explicitly provide that the tax law of the United States, as the source country, is irrelevant in determining fiscal transparency. Nevertheless, the basic inquiry is whether Barbados, as the residence country, will tax the entity or its members. The answer to this question determines whether and to whom the United States will grant treaty benefits.

The older Technical Explanations, such as that for the Barbados treaty, also fail to address the application of the residency provisions to hybrid entities. Thus, the Code Sec. 894 regulations are central to the resolution of the proper treatment. While Barbados investment in the United States through hybrid structures has the benefit of the "better of" approach (treaty or domestic law) provided one is fully informed, U.S. investment in Barbados is uncertain unless similar provisions exist under Barbados domestic law.

Interestingly, notwithstanding the evolution of treaty specification to changing business forms, *i.e.*, partnership to fiscally transparent to hybrid entity, a few treaties negotiated in the past decade have clung to this traditional "partnership" language rather than upgrade to the descriptive term, "fiscally transparent" entity. However, some of the accompanying Technical Explanations address the issue and provide additional guidance. For example, the Technical Explanation to the U.S.-Latvia treaty, signed in 1998, which contains a partnership residency provision virtually identical to that of the Barbados treaty, provides that the characterization of an entity in the source country or in a third country is "irrelevant, even if the entity is organized in that third country."[37] The only characterization that matters is that of the residence country of the person (whether an entity or a member) claiming the treaty benefits.

Finally, as with the modern treaties, the Saving Clause of older treaties would deny benefits to domestic reverse hybrid entities, because they are taxable entities resident in the source state.[38]

3. Modern "Fiscally Transparent Entity" Language: U.S.-United Kingdom Treaty

The U.S.-United Kingdom tax treaty, signed in 2001, contains the "modern" version of the residency provision for conduit enterprises:

> An item of income, profit or gain derived through a person that is fiscally transparent under the laws of either Contracting State shall be considered to be derived by a resident of a Contracting State to the extent that the item is treated for the purposes of the taxation law of such Contracting State as the income, profit or gain of a resident.[39]

This language is virtually identical to a comparable provision contained in the 2006 U.S. Model Treaty,[40] and it modifies the language of the "partnership" provisions of older treaties in two ways. First, the "partnership, estate, or trust" language has been replaced by the broader, more modern phrase "person that is fiscally transparent." Second, the provision refers to the laws of "either Contracting State."

The Technical Explanations of both the Model and United Kingdom treaties explain that a fiscally trans-

parent entity is one that is "not subject to tax at the entity level, as distinct from entities that are subject to tax, but with respect to which tax may be relieved under an integrated system."[41] Accordingly, the new "fiscally transparent" entity language encompasses a broader range of entities, including limited liability companies,[42] than the original language, which, if read literally, might limit the provision's application only to "partnerships." However, the Technical Explanations of many of the older treaties refer to "fiscally transparent entities such as partnerships" and specifically provide that the term "partnership" also applies "to U.S. limited liability companies (LLCs) that are treated as partnerships for U.S. tax purposes."[43] Thus, at least from the perspective of the United States, the provisions of the older treaties conceivably apply to income earned through *any* transparent entity. If so, the new language would not substantively change the operation of the treaty. However, because Technical Explanations are not binding on the other treaty signatory,[44] it is possible for treaty partners to apply the "partnership, estate, or trust" language literally. For instance, Canada did not recognize U.S. limited liability companies as partnerships for treaty purposes until the conclusion of the most recent Protocol to the treaty in September 2007.[45] Thus, the new "fiscally transparent" language embedded in the treaty itself provides additional certainty regarding the qualification for tax treaty benefits.

The effect of including the word "either" in the United Kingdom treaty—if indeed there is any effect—is unclear. Commentators have suggested that the treaty gives both countries more flexibility in determining whether an entity is fiscally transparent.[46] Strangely, this conclusion does not appear to follow from the text of the provision itself. Textually, if the United States is the source country, treaty benefits will arise only if either the entity or its members are United Kingdom residents. The "either" does not add anything of substance, but merely confirms that the rule applies to entities organized in either country and to income that flows in either direction.[47] The crux of the provision is that entitlement to treaty benefits is pinned to satisfaction of the residency requirements. Accordingly, only the tax laws of the country of residence should be controlling.[48] It is uncertain whether these provisions are broader than Code Sec. 894 and apply to active as well as passive income.

The Technical Explanation to the U.S.-United Kingdom treaty provides several examples affirming the view that entitlement to treaty benefits is tied to the tax law of the country of residence. This discussion is then followed by a paragraph that seems to *deny* any flexible treatment by the source country:

> The same result obtains even if the entity were viewed differently under the tax laws of the [source country]. Similarly, the characterization of the entity in a third country is also irrelevant, even if the entity is organized in that third country. The results follow regardless of whether the entity is disregarded as a separate entity under the laws of one jurisdiction but not the other, such as a single owner entity that is viewed as a branch for U.S. tax purposes and as a corporation for U.K. tax purposes. These results also obtain regardless of where the entity is organized (i.e., in the United States, in the United Kingdom, or, as noted above, in a third country).[49]

The United Kingdom treaty also employs a Saving Clause.[50] The Diplomatic Notes to the treaty, which seem to be the source of claims of greater flexibility due to the term "either" in this particular treaty,[51] merely confirm the operation of the Saving Clause. Thus, the United States, as the source country, need not defer to the United Kingdom's tax laws as long as the income is derived by a person or entity taxable as a U.S. citizen or resident. An exception to the general rule applies when both countries can claim that income is derived by a resident.[52]

4. Detailed Treatment of Hybrid Entities: U.S.-Japan Treaty

The 2003 tax treaty between Japan and the United States was the first to contain a more comprehensive provision dealing with hybrid entities.[53] The provision adheres to the general rule that the source country should defer to the tax laws of the residence country. However, instead of simply stating this rule (as do other treaties), the provision details the application of treaty benefits to transparent entities in five different settings. For convenience, we have characterized the United States as the source country in our description below.

Subparagraph (a) of Article 4, paragraph 6 provides that U.S. source income derived through a fiscally transparent Japanese entity is only eligible for treaty benefits if the members of the enterprise are Japanese residents.[54] The last clause is determinative: "without regard to whether the income is treated as the income of such beneficiaries, members or participants under the tax laws of the first-mentioned Contracting State." Assuming that the "first-mentioned Contracting State"

is the United States, the treatment of the entity under U.S. tax laws is irrelevant in determining whether the income is eligible for treaty benefits.

Subparagraph (b) provides that if Japan treats the entity as fiscally opaque/non-transparent, the entity itself is entitled to treaty benefits on the U.S. source income, even if the United States considers the enterprise to be transparent.[55] Subparagraph (c) provides that Japanese members of an entity treated as fiscally transparent under Japanese law and organized in a third country are eligible for treaty benefits on U.S. source income.[56] The treatment of the entity by the United States or the host third country is irrelevant. As long as Japan considers the entity to be transparent (and therefore taxes the income to its resident members), the members are eligible for treaty benefits.

Subparagraphs (d)[57] and (e)[58] describe situations in which no treaty benefits are available. In subparagraph (d), Japan treats a third-country entity as fiscally opaque. Accordingly, Japan will not tax the U.S. source income because the entity is not a resident of Japan. Furthermore, given the Japanese treatment of the entity as non-transparent, the members will not be subjected to current taxation on the entity's receipt of the income. Accordingly, treaty benefits are not available. Denying benefits under the U.S.-Japan treaty makes sense in this situation because neither the entity nor the member is subject to tax in Japan. Of course, the entity may be able to claim benefits under its host country's tax treaty with the United States, if any, so long as the Limitation on Benefits Clause does not prevent it.

> The only characterization that matters is that of the residence country of the person (whether an entity or a member) claiming the treaty benefits.

Subparagraph (e) shifts from an entity organized in a third country to one that is organized in the United States. The entity is treated as fiscally transparent by the United States, but Japan still considers the entity to be opaque. As in subparagraph (d), Japan does not tax any of the members on the income. The entity is not a resident of Japan, and thus the U.S. source income is not taxed by Japan. Therefore, the income is not eligible for treaty benefits at either the entity level or the member level.

These provisions do not add substantively to the general rule of deference to the residence country's definition of the entity. These same results can be reached logically from the more general language found in other treaties. Indeed, the Treasury's Technical Explanation of the U.S.-Japan treaty states, "These results are consistent with provisions addressing fiscally transparent entities in recent U.S. treaties and with U.S. domestic law pursuant to Regulations under section 894(c)."[59] However, they improve the clarity and certainty of the treaty's application and dramatically increase accessibility of the information.

Domestic reverse hybrid entities (treated as opaque in the United States but transparent by Japan) are not addressed by Article 4(6). Because such entities are by definition "residents" of the source state, they fall within the treaty's Saving Clause, which permits each state to tax its citizens or residents notwithstanding other provisions of the treaty.[60] This clause effectively denies treaty benefits to reverse domestic hybrids, an approach which is consistent with the Code Sec. 894 regulations and other modern treaties.

5. Denial of Benefits to Members of Hybrid Entities: U.S.-Canada Treaty

The most recent Protocol to the Convention between the United States of America and Canada with Respect to Taxes on Income and on Capital ("Canada treaty") was concluded on September 21, 2007, after nearly a decade of negotiation.[61] It represents a change in the treatment of hybrid structures in cross-border transactions involving the United States' single largest trading partner. Under the Protocol, treaty benefits are explicitly denied to residents of one contracting state who receive income, gain or profit from a hybrid entity that is a resident of the other contracting state.[62] Commentators have speculated that the Protocol's anti-hybrid provisions are aimed at particular structures perceived as abusive by the two governments; however, the scope of the Protocol's plain language is much broader than the targeted transactions.[63]

Prior to adoption of the Protocol, Canada did not recognize United States limited liability companies as partnerships for treaty purposes.[64] To remedy this unfavorable situation, Article 2 of the Protocol has added two sections to the treaty's residence provision; the first creates a favorable rule for fiscally transparent entities such as limited liability companies, and the second creates an

unfavorable exception for many hybrid entities.[65] The general rule, which will be found in Article IV, paragraph 6 of the integrated treaty, provides that an item of income is derived by a resident of the United States if three requirements are satisfied. First, the person claiming treaty benefits must be considered to have derived the income through an entity that is fiscally transparent under the laws of the United States.[66] Second, the fiscally transparent entity must not be a resident of Canada.[67] Finally, the U.S. tax laws must treat the income derived through the entity in the same manner as if it had been derived directly by the person who is claiming treaty benefits.[68] Under this rule, Canada must recognize members of U.S. passthrough entities who pay United States income tax as residents of the United States who are eligible for treaty benefits.

Article 2 of the Protocol, which will amend Article IV of the treaty, creates a striking exception to the generally favorable rule. It provides that "[a]n amount of income, profit or gain shall be considered not to be paid to or derived by a person who is a resident of a Contracting State" in two situations. First, income will be deemed not to be paid to a resident if it passes through an entity that is classified as fiscally transparent by the country of source but which is treated as opaque by the country of residence.[69] Second, income received from a source country resident will be deemed not to be paid to a resident if it passes through an entity that the country of source classifies as opaque, but which the country of residence perceives as fiscally transparent.[70] The result in the first instance is consistent with the United States' approach under the Barbados, United Kingdom and Japan treaties because the denial of treaty benefits is based upon the classification of the hybrid entity in the country of residence. Because the country of residence will not directly tax the members, but rather, will focus its attention on the hybrid entity, the country of source need not cede its jurisdiction over the members. In this instance, because the potential for double-taxation of the members does not exist, they need no recourse to treaty benefits. Finally, it is worth noting that the Protocol does not deny treaty benefits to the entity itself, although the Limitation on Benefits Clause may apply in some cases.

The second situation described by the Canada Protocol is less intuitive when compared to the content of other U.S. treaties. Article 2(7)(b) of the Protocol specifies that income will be deemed not to be paid to a resident if it is paid by a source country entity that the country of source classifies as opaque, but which the country of residence perceives as fiscally transparent resulting in a difference in tax treatment between the two countries. The Barbados, United Kingdom and Japan treaties, in contrast, focus primarily upon hybrid payees rather than hybrid payors. Although we do not deal at length with the difficulty presented by hybrid payors, we note that Article 2(7)(b) should prove to be an effective government weapon against the improper use of disregarded entities in Canadian cross-border transactions.

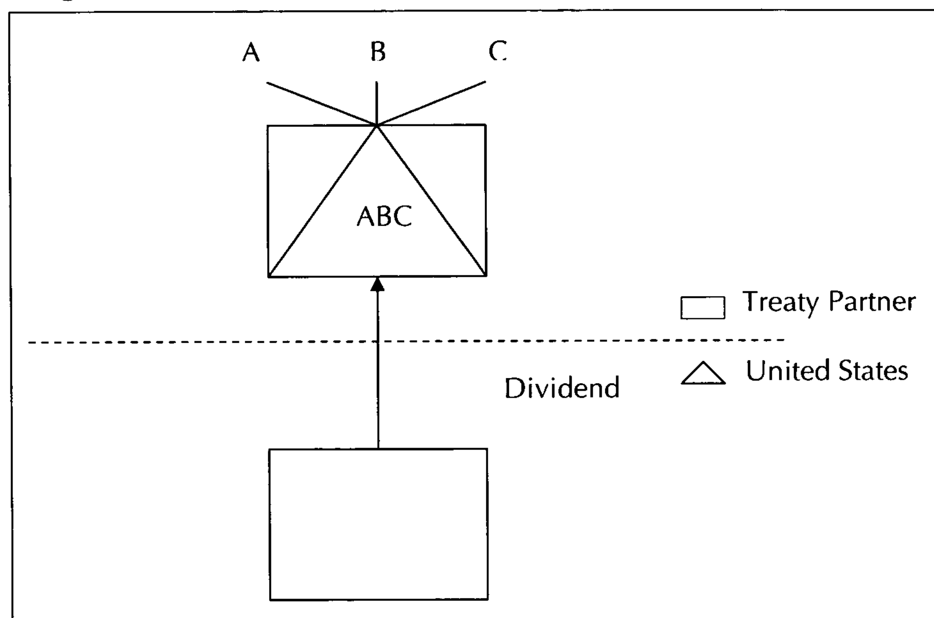
IV. Examples Applying the Hybrid Entity Provisions

From the discussion above, it is apparent that most treaties involving the United States do not employ the term "hybrid entity." Nevertheless, as suggested, most are literally susceptible to an interpretation that is consistent with the text of the Code Sec. 894 regulations and, unless specified to the contrary, the "better of" rule of domestic law pursuant to Code Sec. 894 will apply.

The following scenarios illustrate the application of these principles in a variety of hybrid entity situations. The initial examples involve two countries: the source country (the United States) and the treaty partner country in which the entity and the members reside. Thereafter, more complex settings are examined involving three countries: the source country (the United States), the country in which the entity is organized (treaty country #1), and the country in which some of the entity's members reside (treaty country #2).[71] Each scenario described below is accompanied by a diagram in which a triangle represents a transparent entity and a rectangle represents an opaque entity. A small triangle or rectangle underneath the words "United States" indicates how the source country treats the entity.

Each country characterizes the entity as either opaque or transparent. For each scenario, the issue is whether the United States, as the source country, must grant treaty benefits to the entity, its members, both or neither. We consider the results arising under the Code Sec. 894 regulations and the four basic types of treaty provisions described above: (1) those of the traditional Barbados treaty,

Diagram 5. Scenario 1



(2) the modern United Kingdom treaty, (3) the highly specific Japan treaty, and (4) the Canada Protocol, which explicitly denies benefits to the members of many hybrid entities.

1. Scenario 1—United States Classifies the Entity As *Transparent*; Treaty Partner Classifies the Entity As *Opaque*

Code Sec. 894 Regulations. Under Reg. §1.894-1(d)(1), the entity is a foreign regular hybrid that is eligible for treaty benefits. The members, however, are not eligible for benefits. Because the entity is a resident of the treaty partner, it is treated as opaque and thus taxable. Accordingly, "the item of income is derived by a resident of the applicable treaty jurisdiction."[72] Subject to the Limitation on Benefits Clause, treaty benefits are available to the resident entity which will be taxed currently on the income, and no income is derived by the members under the law of the treaty partner. The entity may claim treaty benefits even though the United States treats the entity as transparent.

Barbados. The same result should obtain under Article 4, paragraph 1(b) of the Barbados treaty. The entity, and not the members, is "subject to tax" by the treaty partner. If the enterprise is an LLC, some uncertainty exists. However, barring provisions to the contrary under Barbados law, the Code Sec. 894 regulations should be applicable as well.

United Kingdom. The same result obtains under Article 1, paragraph 8 of the United Kingdom treaty. Although the treaty does not employ the term "hybrid entity," the Technical Explanation specifies that hybrid entities should be treated similarly to other fiscally transparent enterprises. The U.S. source payments are treated "as the income, profit, or gain of a resident" of the treaty partner. Given the intent of the treaty to govern hybrid entities, the regulations are not as important in resolving the issue.

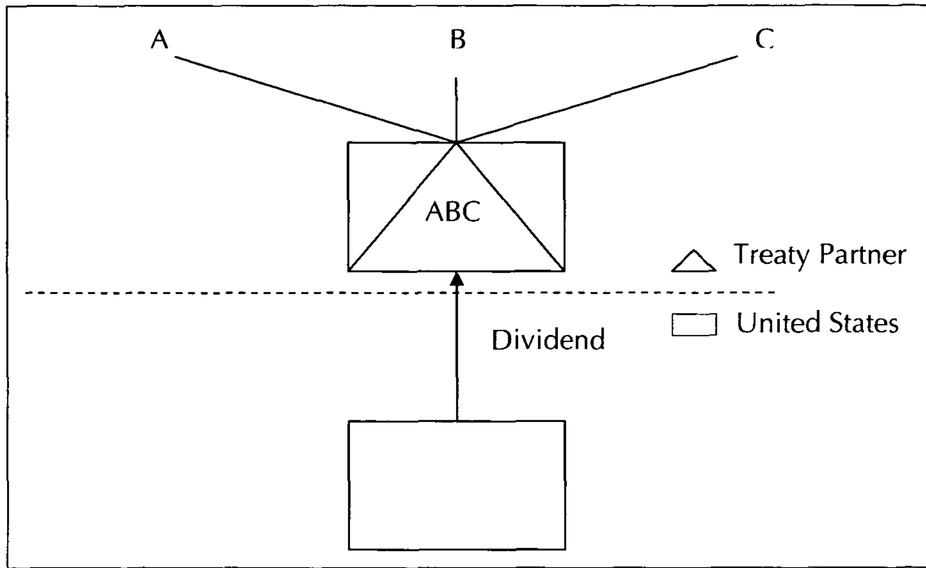
Japan. The same result obtains under Article 4, paragraph 6(b) of the Japan treaty, which explicitly provides that the entity in this scenario will be eligible for treaty benefits, even though the United States treats the entity as transparent. However, the members are *not* eligible for treaty benefits under Article 4, paragraph 6(a), because the payments are income to the entity, not to the members.

Canada. Under Article 2(7)(a) of the recently concluded Protocol with Canada, the members will not be entitled to treaty benefits. The plain language of the Protocol does not prevent the entity from claiming benefits, however. The entity must rely on Article III(f) of the treaty, which provides via definition that "any entity which is treated as a body corporate for tax purposes" is a person that may be a resident for purposes of Article I (Personal Scope) and Article IV (Residence). This result should be the same as that reached under the Barbados, United Kingdom and Japan treaties, although the Protocol's obtuse wording leaves something to be desired from a business planner's perspective.

2. Scenario 2—United States Classifies the Entity As *Opaque*; Treaty Partner Classifies the Entity As *Transparent*

Code Sec. 894 Regulations. The entity is a foreign reverse hybrid entity. While not specifically addressed in the regulation, the logic of the theme governing treaty benefits dictates that the entity is not eligible for treaty benefits because it is treated as fiscally trans-

Diagram 6. Scenario 2



entity is *not* eligible for treaty benefits, because it is treated as fiscally transparent. However, the members qualify for treaty benefits under paragraph 6(c), because they are residents and are subject to tax on the U.S. source income. This is true even though the United States treats the entity as opaque. Furthermore, the Saving Clause is inapplicable because the enterprise was formed in the foreign jurisdiction. The treaty's specificity eliminates the uncertainty otherwise created by the absence of coverage of foreign reverse hybrids in the regulations.

parent by the Treaty Partner. However, the members should qualify for treaty benefits, because the income is "derived by a resident" of the Treaty Partner. Nevertheless, some uncertainty arises as to the proper resolution of the issue because the Regulation fails to address the matter.

Barbados. The Barbados treaty produces a similar result. Under Article 4, paragraph 1(b), the entity is *not* eligible for treaty benefits, because the income in the entity's hands is not "subject to tax" by the Treaty Partner. However, under the same provision, the income is attributed to the members and is "subject to tax" by the Treaty Partner. The members therefore should qualify for treaty benefits. Once again, some uncertainty would arise because the failure of the regulations to address foreign reverse hybrids precludes their incorporation when determining the proper treatment of the transaction.

United Kingdom. The same result should obtain under Article 1, paragraph 8 of the United Kingdom treaty. The income is "treated for the purposes of the taxation law" of the members "as the income, profit or gain of a resident," but the same is not true of the entity. Thus, only the members may be eligible for treaty benefits. As was the case with the Barbados treaty, the failure of the regulations to address foreign reverse hybrids limits the ability to integrate them in resolving the issue.

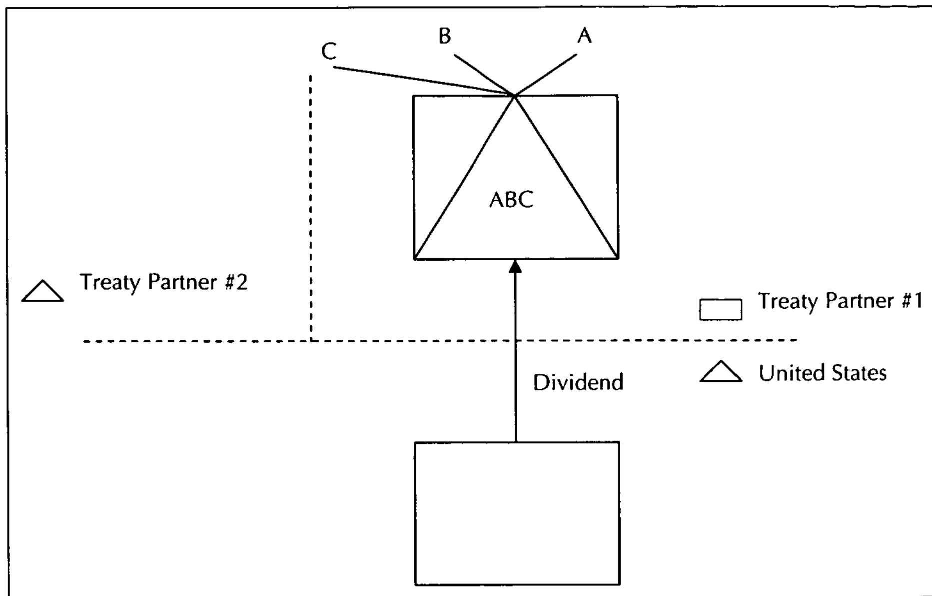
Japan. The more specific provisions of the Japan treaty reach the same result produced by the Barbados and United Kingdom treaties. Under Article 4, paragraph 6(a) of the Japan treaty, the

Canada. Canada, as the county of residence, views the entity as transparent, while the United States, as the country of source, views it as opaque. Under Article 2(6) of the new Protocol, the members of the entity will be eligible to receive treaty benefits so long as the entity is not a resident of the United States.[73] Finally, unlike the first scenario, it is clear that the United States is not required to afford treaty benefits to the entity itself, because the entity is not otherwise considered to be a resident of Canada for treaty purposes.

3. Scenario 3—United States Classifies the Entity As *Transparent;* Treaty Partner #1 Classifies the Entity As *Opaque*; Treaty Partner #2 Classifies the Entity As *Transparent*

Code Sec. 894 Regulations. The entity is a foreign regular hybrid entity. Under Reg. §1.894-1(d)(1), and subject to the Limitation on Benefits Clause, both the entity and some of its members are eligible for benefits, because in both Treaty Country #1 and Treaty Country #2, "the item of income is derived by a resident." The country of formation regards the entity as a resident, and the country of member C's residence regards the member similarly. Importantly, A and B would not be entitled to benefits as they are not subject to tax on the income of Treaty Partner #1. It is also significant that treaty benefits in this scenario are governed by different treaties—the benefits available to the entity are governed by the convention

Diagram 7. Scenario 3



members qualify under Article 4, paragraph 6(c).[74]

Canada. As in Scenario 1, the new Protocol with Canada seems to deny treaty benefits to members of the entity who reside in Canada.[75] As in the first scenario, however, the entity itself may be eligible for benefits under the treaty's more general provisions. Furthermore, member C's eligibility is not governed by the agreement between the United States and Canada; rather, it is governed by the convention between the United States and Treaty Partner #2, which may be more forgiving than the Protocol. If the entity is not a resident of the United States, Article 2(6) would seem to allow access to treaty benefits.

with Treaty Partner #1, while the benefits available to the members are governed by the convention with Treaty Partner #2. Once again, the United States' characterization of the entity is irrelevant.

Barbados. The general provision of Article 4, paragraph 1(b) of the Barbados treaty should grant benefits to either the entity or its members, depending upon which constitutes a resident of its jurisdiction. The treaty language should encompass both, because the income is subject to tax "either in [the entity's] hands or in the hands of its partners or beneficiaries." In such a case, where benefits are available to both an entity and its members, the regulations under Code Sec. 1441 prohibit the duplication of benefits and address their allocation among the eligible parties. These provisions are discussed in greater detail below. Again, the treatment of the entity in the United States is irrelevant. Furthermore, integration of the principles of the Code Sec. 894 regulations is available if needed.

United Kingdom. The same result obtains under Article 1, paragraph 8 of the United Kingdom treaty because the income "is treated for the purposes of the taxation law of such Contracting State as the income, profit or gain of a resident." The Technical Explanation to the treaty ensures that, from the perspective of the United States, the existence of a hybrid entity is irrelevant and thus produces the results which would arise under the regulations if needed.

Japan. If the provisions of the Japan treaty governed this scenario, the entity and its members would be eligible for treaty benefits. The entity qualifies for benefits under Article 4, paragraph 6(b), while the

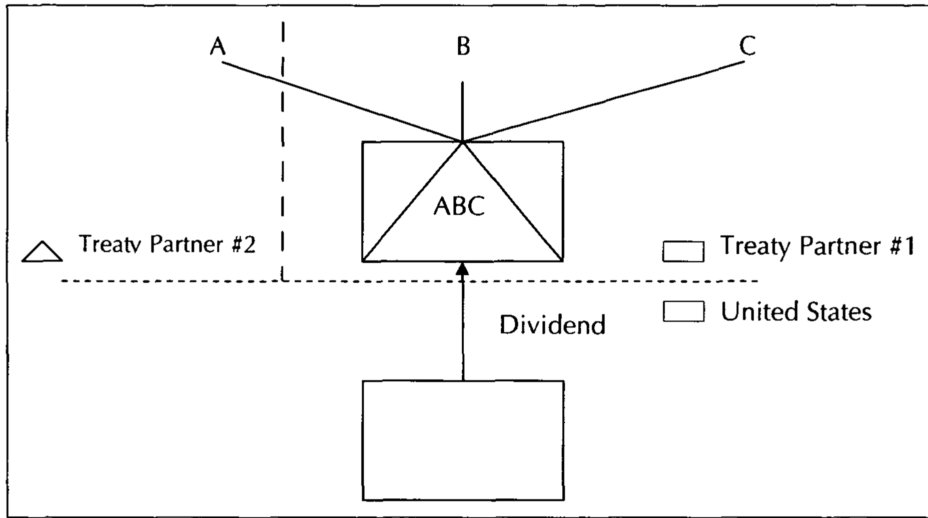
4. Scenario 4—United States Classifies the Entity As *Opaque*; Treaty Partner #1 Classifies the Entity As *Opaque*, and Treaty Partner #2 Classifies the Entity As *Transparent*

The analysis in this scenario is identical to that for scenario 3, even though the United States now treats the entity as opaque rather than transparent. Both the entity and some of its members will be eligible for treaty benefits under the Barbados, United Kingdom and Japan treaties and the Code Sec. 894 regulations as discussed in scenario 3. In addition, the result becomes more certain under the Canada treaty. As between the United States and Canada, the entity is not a hybrid, and the general treaty provisions should provide benefits to the entity. As in scenario 3, the Canadian members need not be considered.

5. Scenario 5—United States Classifies the Entity As Opaque; Treaty Partner #1 Classifies the Entity As Transparent

An exception to the general rule arises in a domestic reverse hybrid situation, *i.e.,* the United States treats the entity as opaque, while the entity's and/or members' country regards it as transparent.

Diagram 8. Scenario 4



In this case, the entity is a corporation of the United States. Thus, the United States is free to tax the entity's income, even though the entity's members may also be subject to tax on the same income in their country of residence. This result arises from the Saving Clause of the various treaties discussed above. The Saving Clause of the Barbados treaty provides that "a Contracting State may tax its residents, ... and by reason of citizenship may tax its citizens, as if the Convention had not come into effect."[76] The United Kingdom, Japan and Canada treaties function similarly.[77] Finally, the Code Sec. 894 regulations explicitly deny treaty benefits for domestic reverse hybrids.[78]

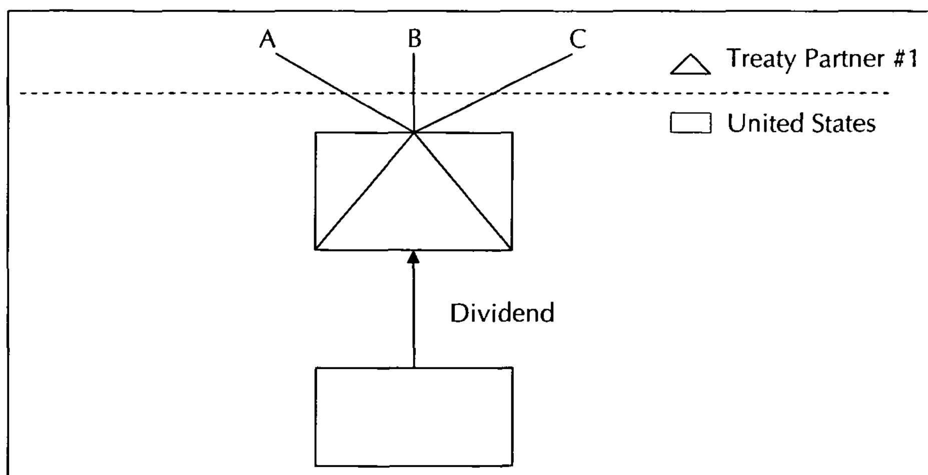
6. Withholding Regulations for Dual Treaty Benefits

In some of the above scenarios, both the entity and some of its members are entitled to a reduced withholding rate under their respective treaties. This raises the question of which treaty applies, particularly when the two treaties call for different rates of withholding. The Treasury Regulations provide guidance.[79]

The basic rule is that only one treaty-reduced rate may apply to a particular item (or portion of an item) of income.[80] A withholding agent cannot layer the various reduced rates from all applicable treaties on top of one another.[81] However, different treaty withholding rates can be applied to the respective portions of the income received (or deemed received) by each member, according to the rate stated in the applicable treaty for each member's jurisdiction.[82] In other words, a single payment to a foreign entity may be divvied up and different withholding rates applied to each portion.

Procedurally, if both an entity and a member claim benefits for the same portion of the income, the withholding agent may choose which rate to apply.[83] However, when a member is entitled to a lower rate of withholding than is the entity to which the payment is made, the member should request this lower rate. In the event that the member is "short-changed" by the withholding agent, it can subsequently claim a refund or credit.[84] Thus, in a practical sense, the lowest rate of any relevant treaty will ultimately apply to a particular portion of an income item (although the rate initially applied by the withholding agent may determine whether the "extra" money ends up in the hands of the entity or its members).[85] Where no Limitation on Benefits Clause applies, this rule potentially allows business entities to benefit from lenient tax treaties negotiated by countries other than the entity's host country. However, a contrary rule would deny members the full enjoyment of tax treaties negotiated by their own host countries.

Diagram 9. Scenario 5



V. Conclusion

The United States' incorporation of hybrid entity language into its tax treaties is beneficial because it brings certainty to cross-border transactions. It draws clear lines for IRS agents who must assess transactions involving hybrid entities, and it obviates investors' need to rely on the Code Sec. 894 regulations. The Code Sec. 894 regulations provide for their application in all treaty settings unless a treaty specifically addresses the matter; thus, the "better of" (the treaty or domestic law) approach is generally applicable with respect to foreign investment in the United States. Although consistent results should arise under this approach unless a particular governing treaty specifically rejects the approach of the regulations, the need for treaty language addressing hybrid entities remains. Because the United States does not consistently follow the OECD's lead on international tax matters, investors in U.S. cross-border transactions cannot necessarily rely on the Partnership Report and OECD Model Treaty explanation for guidance when interpreting older conventions. Furthermore, the Code Sec. 894 regulations require both foreign and domestic investors to look to foreign sources of law, which may not be readily understandable, translatable or even stable. As a result, while the Code Sec. 894 regulations function as an adequate backstop, they cannot provide the same solid footing that results from clear, modern, and understandable language embodied in an applicable treaty. By incorporating such language into the treaties themselves, the United States can provide certainty to domestic and foreign taxpayers who structure their investments through such vehicles.

A second source of interpretive certainty has been harmonization. The United States' focus on the residence country's classification of hybrid entities is aligned with the OECD approach and should therefore be easily understandable to most foreign investors. Furthermore, uniform adoption of the language employed by the United Kingdom treaty or the Japan treaty would allow taxpayers to consider the administrative and judicial interpretations of U.S. conventions with other treaty partners when planning transactions under their own applicable treaty. Such harmonization across treaties has already occurred to an extent. Language similar to the hybrid entity provision of the United Kingdom treaty appears in a number of other agreements, including recently concluded treaties or protocols with Denmark, Finland, Germany, Belgium and Sweden.[86]

Still, even perfectly harmonized adoption of hybrid provisions similar to the United Kingdom or Japan treaties would not consistently achieve the ideal result of one country taxing a particular item of income only once. Problems of double taxation and double nontaxation would still arise because treaty benefits are based on tax jurisdiction, rather than *actual* taxation. If an entity is "subject to tax" in a country that chooses not to tax a particular item of income, that income may escape taxation completely.[87] Some commentators have suggested requiring actual taxation as a prerequisite to treaty benefits, either in the Code Sec. 894 regulations or the treaties themselves. However, this approach could result in greater administrative difficulties, and it could also weaken legitimate tax incentives offered to investors by treaty partners.

The United States' incorporation of hybrid entity language into its tax treaties is beneficial because it brings certainty to cross-border transactions.

Ultimately, it is the countries themselves that must choose to exercise their tax jurisdiction. In some circumstances, countries might find that tax treaty provisions are contrary to the national interest. For example, the Dutch Secretary of Finance refused to enforce the new United States-Netherlands tax treaty provision governing treaty eligibility of hybrid entities and their members because its adoption posed a threat to foreign investment.[88] In such a situation, no amount of harmonization or clarification on the part of the United States can unilaterally achieve the treaty's stated goals of eliminating both double taxation and fiscal evasion.

In the end, we must conclude that tax treaties operate in an inherently messy international landscape. For now, it seems that United States treaty negotiators have at least grasped the problems posed by hybrid entities and are moving toward a sensible solution. Recent tax treaties with Japan and the United Kingdom are in accord with the OECD approach and should point the way toward more explicit provisions regarding hybrid entities as the United States renegotiates many of its older treaties. We applaud the Japan treaty's specificity for its ease of use and its

clear applicability and the United Kingdom treaty's broadly drafted provision for its ability to address unanticipated business forms and transactions that may arise in the future. In contrast to the provisions of the new Canada Protocol, which are inscrutable at first blush, the provisions of the Japan and United Kingdom treaties are detailed, readily decipherable, and in keeping with most other approaches to hybrid entity treaty eligibility. Finally, if one were to predict an ideal future for treaty coverage, it would be that all new treaties and most renegotiated treaties would specifically address hybrid entities as was done in the Japan treaty, or as a close second, in the United Kingdom treaty, and that these provisions would be harmonized across treaty partners. In such harmonization, we would anticipate certainty, and with certainty, a better environment in which to conduct international business.

ENDNOTES

* The authors would like to thank Professors Michael Kirsch, Adam Rosenzweig and Robert Wootton for their thoughtful comments. All errors, of course, are our own.

1 Reg. §§301.7701-1, 301.7701-2 and 301.7701-3. *See generally* WILLIS, PENNELL & POSTLEWAITE, PARTNERSHIP TAXATION, Chapters 1, 3 and 21 (6th ed. 1997).

2 For a more comprehensive treatment of the check-the-box regulations and commentary on their difficulties, *see* Philip F. Postlewaite, *The Check-the-Box Regulations Turn 10—Will We Survive Their Teenage Years?* J. TAX'N GLOBAL TRANS., Spring 2006, at 35.

3 Even this specification is puzzling at times. The United States State Department currently recognizes 194 independent states. *See www.state.gov/s/inr/rls/4250.htm.* Thus, for a large number of countries that do not appear on the list, presumably any enterprise, including one which is publicly traded, can check the box. Countries on the list fall into two categories, one group appears to focus on publicly traded status, *e.g.*, United Kingdom where only Public Limited Companies are denied the election while the other looks to separate entity status regardless of whether it is publicly or privately held, *e.g.*, Argentina where the Sociedad Anonima has *per se* status.

4 Reg. § 301-7701-3(a).

5 *Id.*

6 *Id.*

7 Reg. §301.7701-3(b) and 301.7701-3(b)(2).

8 *See* Reg. §1.894-1(d)(4) ("a reduced rate under a tax treaty for an item of U.S. source income paid will not be available irrespective of [this Regulation] to the extent that the applicable treaty jurisdiction would not grant a reduced rate under the tax treaty to a U.S. resident in similar circumstances, as evidenced by a mutual agreement between the relevant competent authorities or by a public notice of the treaty jurisdiction").

9 *Id.*

10 *Id.*

11 The Preamble notes, "The approach adopted in these final regulations is consistent with the evolving multilateral consensus among the member countries of the Organization for Economic Cooperation and Development (OECD) on the appropriate method for source countries to follow to determine if they should provide treaty benefits on items of income paid to fiscally transparent entities, particularly when an entity classification conflict exists between the source and residence states." T.D. 8889, 2000-1 CB 124 (June 30, 2000).

12 OECD, The Application of the OECD Model Tax Convention to Partnerships, Issues in International Taxation No. 6, 8 (1999).

13 *Id.*, at 12.

14 OECD Partnership Report, at 14.

15 *Id.*, at 22.

16 There have been some exceptions. For instance, in 2005, the United States and Mexico entered into a mutual agreement that provides that income received by an entity that is "fiscally transparent under the laws of either Contracting State" will be treated as the income of a resident if it will be taxed in the hands of members who are residents. *See* Competent Authority Mutual Agreement, IRB 2006-4, 344 (Dec. 22, 2005). A similar agreement exists with Spain. *See* IRB 2006-14, 703 (Apr. 3, 2006). It provides that an item of income received by an LLC, or other entity, whether organized within or without the United States, that is treated for U.S. federal tax purposes as a partnership or disregarded as an entity separate from its owner, will be treated as income derived by a resident of the United States to the extent that income received by the LLC or other entity is subject to U.S. tax as the income of a U.S. resident. New Zealand has made a similar pact. *See* IRB 2005-10, 673 (Feb. 10, 2005).

17 United States Model Income Tax Convention of November 15, 2006, Art. 1(6).

18 For instance, *see* Convention between the Government of the United States of America and the Government of the Kingdom of Denmark for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income (1999), Art. 4(1)(d); Protocol Amending the Convention between the Government of the United States of America and the Government of Sweden for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income (2005), Art. 1(6); Protocol Amending the Convention between the Government of the United States of America and the Government of the Republic of Finland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and on Capital (2006), Art. 1(6); Convention between the Government of the United States of America and the Government of the Kingdom of Belgium for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income (2006), Art. 1(6); and Protocol Amending the Convention between the Government of the United States of America and the Government of the Federal Republic of Germany for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital and to Certain Other Taxes (2007), Art. 1(7) among others. One wonders, as an interpretive matter, whether the explicit adoption of this language as a matter of course in the U.S. conventions will prevent it from relying on the OECD's Report and commentary in cases where it is unable to secure an amending protocol. In the end, it may matter little, as the language has been incorporated into a number of existing U.S. conventions.

19 Lee Sheppard, *U.S. Hybrid Problems under Improved Treaty Regulations,* 21 TAX NOTES INT'L 309 (July 24, 2000).

20 Although well-advised pre-check-the-box investors could create hybrid entities through careful research and planning, the Treasury's adoption of the check-the-box regulations brought hybrid entities into the general parlance of international taxation.

21 Department of the Treasury Technical Explanation of the Protocol Signed at Washington on September 30, 2005 Amending the Convention Between the United States of America and the Government of Sweden for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, Signed at Washington on September 1, 1994, Art. 1(b); Department of the Treasury Technical Explanation of the Protocol Signed at Helsinki on May 31,

ENDNOTES

2006, Amending the Convention Between the Government of the United States of America and the Government of Finland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital, Signed at Helsinki on September 21, 1989, para. 6; Department of the Treasury Technical Explanation of the Convention Between the Government of the United States of America and the Government of the Kingdom of Belgium for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income Signed at Brussels on November 27, 2006, para. 6; Department of the Treasury Technical Explanation of the Convention Between the Government of the United States of American and the Government of the People's Republic of Bangladesh for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income Signed at Dhaka on September 26, 2004; Department of the Treasury Technical Explanation of the Convention Between the Government of the United States of America and the Government of Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital Gains Signed at Dublin on July 28, 1997, para. 56–60.

[22] *See* Protocol Amending the Convention between the United States of America and Canada with Respect to Taxes on Income and on Capital (Sept. 26, 1980) as Amended by The Protocols Done on June 14, 1983, March 28, 1984, March 17, 1995 and July 29, *available at www.ustreas.gov/offices/tax-policy/library/CanadaProtocol07.pdf.*

[23] Reg. §1.894-1(d)(2)(i).

[24] Reg. §1.894-1(d)(1).

[25] Reg. §1.894-1(d)(4) ("Unless otherwise explicitly agreed upon in the text of an income tax treaty, the rules contained in this paragraph (d) shall apply in respect of all income tax treaties to which the United States is a party.")

[26] T.D. 8889, 2000-1 CB 124 (June 30, 2000).

[27] Reg. §1.894-1(d)(3)(i).

[28] Reg. §1.894-1(d)(3)(ii)(A). The regulations specify that an entity's jurisdiction "is the jurisdiction where the entity is organized or incorporated or may otherwise be considered a resident under the laws of that jurisdiction." Reg. §1.894-1(d)(3)(ii)(B).

[29] *Id.* (requiring that "the character and source of the item in the hands of the interest holder are determined as if such item were realized directly from the source from which realized by the entity").

[30] Reg. §1.894-1(d)(3)(iii)(A). The interest holder's jurisdiction "is the jurisdiction where the interest holder is organized or incorporated or may otherwise be considered a resident under the laws of that jurisdiction." Reg. §1.894-1(d)(iii)(B).

[31] *Id.*

[32] Reg. §1.894-1(d)(1). There is one exception: notwithstanding the regulation's general prohibition, "an item of income paid directly to a type of entity specifically identified in a treaty as a resident of a treaty jurisdiction shall be treated as derived by a resident of that treaty jurisdiction." *Id.*

[33] Reg. §1.894-1(d)(2)(i).

[34] T.D. 8889, 65 FR 40993 (July 3, 2000).

[35] *See* Art. 4(a)(i) and 4(b)(i), Convention between Barbados and the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, Dec. 31, 1984.

[36] *Id.* A similar provision applies to partnerships, estates and trusts resident in Barbados.

[37] Department of the Treasury Technical Explanation to the United States-Latvia Income Tax Convention, Art. 4, para. 2(b) (p. 12).

[38] *E.g.,* U.S.-Barbados Income Tax Convention, Art. 1, para. 3.

[39] Convention Between the Governments of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland For the Avoidance of Double Taxation and the Prevention of Fiscal Evasion With Respect to Taxes on Income and Capital Gains, Signed July 24, 2001, Art. 1, para. 8. This language raises the question of whether the treaty requires residency on the part of the entity, or rather, on the part of the beneficiaries. In other words, it is not immediately clear whether the treaty envisions the entity or its owners as the recipients of the treaty benefits. However, in the case of a transparent entity, it is the owners, and not the entity, who file returns. Reg. §1.894-1(d)(1), which specifies that an entity will be treated as a resident when specifically granted that designation by treaty, also implies that the envisioned benefit recipients are the owners of a transparent entity, not the entity itself.

[40] United States Model Income Tax Convention of November 16, 2006, Art. 1, para. 6.

[41] United States Model Technical Explanation Accompanying the United States Model Income Tax Convention of November 15, 2006, Art. 1, para. 6; Department of the Treasury Technical Explanation of the Convention Between the Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and on Capital Gains, Art. 1, para. 8.

[42] *See id.*

[43] *E.g.,* Department of the Treasury Technical Explanation to the United States-Latvia Income Tax Convention, Art. 4, para. 2(b) (p. 12).

[44] Nicoles J. Muniz, *Emerging International Consensus on Treaty Benefits,* 31 TAX NOTES INT'L 1055 (Sept. 22, 2003).

[45] *See* Matthew Peters and Joanna Barsky, *Canada-U.S. Tax Treaty Protocol: Where Have All the Hybrids Gone?* 117 TAX NOTES 955 (Dec. 3, 2007) (noting that the CRA has traditionally refused to recognize LLCs as the equivalents of either corporations or partnerships for treaty purposes).

[46] Lee Sheppard, *Treaty Protection for Hybrid Entities?* 34 TAX NOTES INT'L 678 (May 17, 2004).

[47] The drafters may have used the word out of an abundance of caution to prevent taxpayers from arguing that the hybrid-limiting provision literally does not apply where an entity is organized in a third jurisdiction and is viewed as opaque by the country of residence. Of course, the Limitation on Benefits Clause, if one exists, may apply in this scenario.

[48] Belgium (2006), Finland (2006), Germany (2001), Sweden (2005) and France (2004) possess such language, but the Technical Explanation clearly extends its coverage to hybrid settings. The Competent Authority Agreement with Mexico (2005) takes a similar approach. *See also* Italy (1999), Mexico (2002), Slovenia, South Africa (1997) and Thailand (1996). In addition to the United Kingdom and Netherlands treaties, 10 other U.S. tax treaties have "modern" partnership provisions: Denmark (signed in 2000), Bulgaria (2007), Germany (2006), Slovenia (1999), South Africa (1997), Sri Lanka (2002), Australia (2001) and Venezuela (1999). The Technical Explanation to the Bangladesh treaty (2004) indicates that its interpretation includes the concept of "fiscally transparent." Unlike the United Kingdom and Netherlands treaties, these treaties were not accompanied by a provision in the Diplomatic Notes or Technical Explanation that dealt directly with hybrid entities.

[49] Department of the Treasury Technical Explanation to the U.S.-United Kingdom Income Tax Convention (2001), Art. 1, para. 8 (p. 8).

[50] U.S.-United Kingdom Income Tax Convention (2001), Art. 1, para. 4:

> Notwithstanding any provision of this Convention except paragraph 5 of this Article, a Contracting State may tax its residents (as determined under Article 4 (Residence)), and by reason of citizenship may tax its citizens, as if this Convention had not come into effect.

ENDNOTES

[51] Roger Berner and Gregory May, *The New U.K.-U.S. Income Tax Treaty*, PRACTICING LAW INSTITUTE, Sept.–Nov. 2006.

[52] Diplomatic Notes to U.S.-U.K. Double Taxation Convention (2001), with reference to Article 24 (Relief from Double Taxation).

[53] Pamela A. Fuller, *The Japan-U.S. Income Tax Treaty: Signaling New Norms, Inspiring Reforms, or Just Tweaking Anachronisms in International Tax Policy?* 40 INT'L LAW 773 (2006).

[54] United States-Japan Tax Treaty, Art. 4, para. 6(a):

> (a) An item of income:
>
> (i) derived from a Contracting State through an entity that is organized in the other Contracting State; and
>
> (ii) treated as the income of the beneficiaries, members or participants of that entity under the tax laws of that other Contracting State;
>
> shall be eligible for the benefits of the Convention that would be granted if it were directly derived by a beneficiary, member or participant of that entity who is a resident of that other Contracting State, to the extent that such beneficiaries, members or participants are residents of that other Contracting State and satisfy any other conditions specified in the Convention, without regard to whether the income is treated as the income of such beneficiaries, members or participants under the tax laws of the first-mentioned Contracting State.

[55] U.S.-Japan Tax Treaty, Art. 4, para. 6(b):

> (b) An item of income:
>
> (i) derived from a Contracting State through an entity that is organized in the other Contracting State; and
>
> (ii) treated as the income of that entity under the tax laws of that other Contracting State;
>
> shall be eligible for the benefits of the Convention that would be granted to a resident of that other Contracting State, without regard to whether the income is treated as the income of the entity under the tax laws of the first- mentioned Contracting State, if such entity is a resident of that other Contracting State and satisfies any other conditions specified in the Convention.

[56] U.S.-Japan Tax Treaty, Art. 4, para. 6(c):

> (c) An item of income:
>
> (i) derived from a Contracting State through an entity that is organized in a state other than the Contracting States; and
>
> (ii) treated as the income of the beneficiaries, members or participants of that entity under the tax laws of the other Contracting State;
>
> shall be eligible for the benefits of the Convention that would be granted if it were directly derived by a beneficiary, member or participant of that entity who is a resident of that other Contracting State, to the extent that such beneficiaries, members or participants are residents of that other Contracting State and satisfy any other conditions specified in the Convention, without regard to whether the income is treated as the income of such beneficiaries, members or participants under the tax laws of the first-mentioned Contracting State or such state.

[57] U.S.-Japan Tax Treaty, Art. 4, para. 6(d):

> (d) An item of income:
>
> (i) derived from a Contracting State through an entity that is organized in a state other than the Contracting States; and
>
> (ii) treated as the income of that entity under the tax laws of the other Contracting State;
>
> shall not be eligible for the benefits of the Convention.

[58] U.S.-Japan Tax Treaty, Art. 4, para. 6(e):

> (e) An item of income:
>
> (i) derived from a Contracting State through an entity that is organized in that Contracting State; and
>
> (ii) treated as the income of that entity under the tax laws of the other Contracting State;
>
> shall not be eligible for the benefits of the Convention.

[59] Department of the Treasury Technical Explanation of the 2003 United States-Japan Income Tax Convention, Art. 4, para. 6 (p. 16).

[60] U.S.-Japan Income Tax Convention (2003), Art. 1, para. 4(a):

> Except to the extent provided in paragraph 5, 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.

[61] *See* Protocol Amending the Convention between the United States of America and Canada with Respect to Taxes on Income and on Capital (Sept. 26, 1980) as Amended by The Protocols Done on 14 June 1983, 28 March 1984, 17 March 1995 and 29 July 1997, at 38, *available at www.ustreas.gov/offices/tax-policy/library/CanadaProtocol07.pdf.* The Protocol has not yet been ratified by the Senate. *See* Kristen A. Parillo, *U.S., Canadian Officials Sign Treaty Protocol,* 2007 TNT 185-2 (Sept. 21, 2007).

[62] *See id.*, at Art. 7.

[63] *See* Matthew Peters and Joanna Barsky, *Canada-U.S. Tax Treaty Protocol: Where Have All the Hybrids Gone?* 117 TAX NOTES 955 (Dec. 3, 2007) (noting that the Protocol prevents tax benefits associated with the use of Canadian synthetic nonresident-owned investment companies and with Canadian unlimited liability companies that elect to be treated as disregarded entities). *See also,* Robert J. McDonough, *TEI Comments on U.S.-Canada Tax Treaty Protocol,* 2007 TNT 246-24 (Dec. 21, 2007) (observing that the treaty will have a broad effect for U.S. businesses operating in Canada).

[64] *See* Matthew Peters and Joanna Barsky, *Canada-U.S. Tax Treaty Protocol: Where Have All the Hybrids Gone?* 117 TAX NOTES 955 (Dec. 3, 2007) (noting that the CRA has traditionally refused to recognize LLCs as the equivalents of either corporations or partnerships for treaty purposes).

[65] *See* Article 2(6) and 2(7) of Protocol Amending the Convention between the United States of America and Canada with Respect to Taxes on Income and on Capital Done at Washington on 26 September 1980 as Amended by The Protocols Done on 14 June 1983, 28 March 1984, 17 March 1995 and 29 July 1997, at 38, *available at www.ustreas.gov/offices/tax-policy/library/CanadaProtocol07.pdf.*

[66] *Id.*, at Art. 2(6).

[67] *Id.*

[68] *Id.*

[69] *See* Article 2(7)(a) of Protocol Amending the Convention between the United States of America and Canada with Respect to Taxes on Income and on Capital Done at Washington on 26 September 1980 as Amended by The Protocols Done on 14 June 1983, 28 March 1984, 17 March 1995 and 29 July 1997, at 38, *available at www.ustreas.gov/offices/tax-policy/library/CanadaProtocol07.pdf.* Article 2 provides:

> An amount of income, profit or gain shall be considered not to be paid to or derived by a person who is a resident of a Contracting State where:
>
> (a) The person is considered under the taxation law of the other Contracting State to have derived the amount through an entity that is not a resident of the first-mentioned State, but by reason of the entity not being treated as fiscally transparent under the laws of that State, the treatment of the amount under the taxation law of that State is not the same as its treatment would be if that amount had been derived directly by that person; or
>
> (b) The person is considered under the taxation law of the other Contracting State to have received the amount from an entity that is a resi-

ENDNOTES

dent of that other State, but by reason of the entity being treated as fiscally transparent under the laws of the first-mentioned State, the treatment of the amount under the taxation law of that State is not the same as its treatment would be if that entity were not treated as fiscally transparent under the laws of that State.

[70] *Id.*, at Art.2(7)(b).

[71] *See generally* Richard L. Doernberg and Kees van Raad, *Hybrid Entities and the U.S. Model Income Tax Treaty,* TAX NOTES INT'L, Aug. 23, 1999, at 745. Doernberg and van Raad provide a useful framework for analyzing the effects of various treaty provisions. They posit eight basic scenarios, each involving three countries: the Source Country, the country in which the entity is organized (the Entity Country), and the country in which the entity's beneficiaries reside (the Beneficiary Country). Each country can characterize the entity as either opaque or transparent; with three countries, this results in eight possible scenarios. For each scenario, the question is whether the United States, as the Source Country, should grant treaty benefits to the entity, its beneficiaries, both or neither. We have, like the drafters of the Japan treaty, chosen to use five scenarios. In our examples, as in real life, it is possible that the members can be resident in a country other than the country of the entity's formation.

[72] Reg. §1.894-1(d)(1).

[73] *See* Canada Protocol, Art. 2(6).

[74] In the case of potential dual benefits, as discussed below, the Treasury regulations essentially provide that the lower of the two applicable withholding rates should apply.

[75] *See* Protocol Amending the Convention between the United States of America and Canada with Respect to Taxes on Income and on Capital (Sept. 26, 1980) as Amended by The Protocols Done on 14 June 1983, 28 March 1984, 17 March 1995 and 29 July 1997 at 38, Art. 2(7)(a), *available at www.ustreas.gov/offices/tax-policy/library/CanadaProtocol07.pdf.*

[76] *See* Convention between the Barbados and the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, Art. 1(3) (1984).

[77] *See* Convention between the Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and on Capital Gains, Art. 1(4) (2001); Convention between the Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and on Capital Gains, Art. 1(4)(a) (2003); Convention between the United States of America and Canada with Respect to Taxes on Income and on Capital (1980), Art. XXIX(2).

[78] Reg. §1.894-1(d)(2)(i).

[79] Reg. §1.1441-6(b)(2)(iii).

[80] *Id.*

[81] *Id.*

[82] *Id.*

[83] *Id.*

[84] *Id.*

[85] For examples, *see* Reg. §1.1441-6(b)(2)(iv).

[86] Convention between the Government of the United States of America and the Government of the Kingdom of Denmark for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income (1999), Art. 4(1)(d); Protocol Amending the Convention between the Government of the United States of America and the Government of Sweden for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income (2005), Art. 1(6); Protocol Amending the Convention between the Government of the United States of America and the Government of the Republic of Finland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and on Capital (2006), Art. 1(6); Convention between the Government of the United States of America and the Government of the Kingdom of Belgium for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income (2006), Art. 1(6); and Protocol Amending the Convention between the Government of the United States of America and the Government of the Federal Republic of Germany for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital and to Certain Other Taxes (2007), Art. 1(7).

[87] Of course, this problem is not unique to hybrid entities but may also arise in other cross-border transactional contexts.

[88] *See* Ruben de Witt, *Netherlands to Disregards Hybrid Entity Provision for U.S. Investors,* 2005 TNT 133-6. The relevant provision is Art. 6(e)(4) of the U.S.-Netherlands Tax Protocol (2006). The provision is similar to that in the United Kingdom treaty, and like all current treaties, it pins eligibility for treaty benefits to residency. The old U.S.-Netherlands tax treaty did not contain a hybrid entity provision, creating a number of tax planning opportunities. Essentially, the Secretary's decree will allow United States members of Dutch partnerships to enjoy treaty benefits, even though the partnership is treated in the United States as opaque (probably through a check-the-box election). Thus, the members of a Dutch enterprise will be able to benefit from a reduced withholding rate and defer the payment of tax, even though neither they nor the partnership are subject to tax in the United States—the very result that the hybrid entity provision is designed to avoid. The Secretary was concerned that if the new treaty provision were enforced, many U.S. investors, deprived of their previous advantageous tax treatment, would withdraw their foreign investments from the Netherlands.

Foreign Tax Credits

Continued from page 6

There are six specific factors that must be satisfied under this regulation, and it is easy for a taxpayer to make certain it is not within the scope of these rules. However, even without this new regulation, the IRS has disallowed foreign tax credits in years prior to the effective date of the regulation in transactions considered abusive by the IRS.[8] Even though it is undisputed that the taxpayer is legally liable for the tax in these transactions and, therefore, under the technical taxpayer rule the taxpayer would traditionally be allowed a credit for the foreign income taxes paid, the credits are disallowed. The arguments made by the IRS include Code Sec. 269 and economic substance doctrines, but even a good business purpose is apparently not sufficient to preclude an IRS challenge.[9]

Loss Surrender

The third development, and one that surprised many taxpayers and

practitioners, was Proposed Reg. §1.901-2(e)(5)(iii). This regulation deals with the surrender of losses between members of a group. A basic example would be USP owns 100 percent of UK1 and 100 percent of UK2. UK1 has 300 of income. UK2 has 100 of loss. Under the UK corporate income tax system, UK2 can surrender the 100 loss to UK1 thereby reducing the tax liability of UK1. The question addressed by Proposed Reg. §1.901-2(e)(5)(iii) is whether tax paid by UK1 in the future may be considered a voluntary payment of tax because UK1 surrendered the loss to another taxpayer instead of retaining the loss to offset its own future tax liability. In other words, referring to the description of the voluntary payment rule set forth above, should UK1 and UK2 be considered a single taxpayer, or are there two taxpayers. If there are two taxpayers, the question is whether UK1 has reasonably interpreted and applied the laws of the U.K. to reduce over time its foreign income tax liability if it has surrendered a loss to another taxpayer. The implied conclusion in the proposed regulation is that UK1 may not have reasonably interpreted and applied the laws of the U.K., much to the surprise of many taxpayers.

Proposed Reg. §1.901-2(e)(5)(iii) resolves the purported problem by treating a "U.S.-owned group" as a single taxpayer. Generally a U.S.-owned group includes related entities, which is based on an 80-percent or more ownership threshold. Because of multiple issues that have been identified by taxpayers under this new voluntary payment test, finalization of this new regulation has been delayed for further consideration.[10]

Summary

The technical taxpayer rule and voluntary payment rule have become interrelated. The technical taxpayer rule is evolving away from the basic question of whether a taxpayer is liable for tax as determined under foreign law. Similarly, the voluntary payment rule has evolved to the point where it may apply to disallow a foreign tax credit even though the taxpayer's liability for payment of a foreign income tax under foreign law is undisputed and there is a valid business purpose for paying the tax. The abandonment of a mechanical rule leads to uncertainty both for the IRS and taxpayers. If a foreign income tax paid with respect to a structured passive investment arrangement supported by a valid business purpose is a voluntary payment, and if surrendering a loss to an affiliate creates a voluntary payment exposure, what could be next?

Endnotes

1. This tax is discussed in Notice 2008-3, IRB 2008-2, 253.
2. This tax is discussed in Tax Analysts, Vol. 90, No. 3, at 100 (July 3, 2008).
3. Reg. §1.901-2(e)(5).
4. Rev. Proc. 2006-54, 2002-2 CB 253.
5. Tax Management Transfer Pricing Report, Vol. 17, No. 2, at 50 (May 22, 2008).
6. Reg. §1.905-4T.
7. Reg. §1.901-2T(e)(5)(iv).
8. TAM 200807015 (Feb. 15, 2008); ILM 200826036 (Feb. 29, 2008).
9. In both the preamble to the proposed regulation and the preamble to the final regulation, the IRS discussed and rejected a valid business purpose test.
10. Notice 2007-95, IRB 2007-49 (Nov. 19, 2007).

Income Tax Evasion

Continued from page 32

and exemplary voluntary compliance. The government should deal with tax evaders by appealing to their sense of patriotism and initiating public relations campaigns. In conclusion, the combination of "carrot and stick" policies may motivate taxpayers to comply voluntarily with a more objective and fair system of income taxation.

Endnotes

1. Y. Margalioth, *Tax Competition, Foreign Direct Investments and Growth: Using the Tax System to Promote Developing Countries,* 23 Virginia Tax Rev. 161 (2003).
2. R.S. Avi-Yonah, *The Three Goals of Taxation,* 60 Tax Law Rev. 1 (2006).
3. Constitution of Jordan, Official Gazette No. 1093 (Jan. 8, 1952).
4. K.W. Simon, *Congress and Taxes: A Separation of Powers Analysis,* 45 U. Miami Law Rev. 1005 (1991).
5. Income Tax Law No. 57 of 1985, Official Gazette No. 3343 (Oct. 1, 1985) as amended by Provisional Law No. 24 of 2005 Official Gazette No. 4732 (Nov. 30, 2005).
6. M.A. Livingston, *Blum and Kalven at 50: Progressive Taxation, "Globalization," and the New Millennium,* 4 Florida Tax Rev. 731 (2000); T.D. Griffith, *Progressive Taxation and Happiness,* 45 Boston College L. Rev. 1363 (2004); M.E. Kornhauser, *Rethinking Redistribution: Tax Policy in an Era of Rising Inequality: Choosing a Tax Rate Structure in the Face of Disagreement,* 52 UCLA L. Rev. 1697 (2005).
7. P.W. Moore, Doing Business in the Middle East: Politics and Economic Crisis in Jordan and Kuwait (2004).
8. *Supra* note 5, at article 16.b.
9. *Supra* note 5, at article 5.a.
10. Supra note 5, at article 36.
11. Jordanian Court of Cassation Case No. 377/93 (1993).
12. A. Habeeb, Tax Planning in Operating Banks in Jordan, unpublished M.Sc. Thesis, University of Jordan, Jordan (on file with the University of Jordan Library) (1994).
13. Black's Law Dictionary (1999).
14. *Supra* note 5, at article 42.
15. *Id.*
16. M. Najm, Textbook of Criminal Law, Dar Al-Thaqafa for Publication and Distribution, Amman, Jordan (2006).
17. Central Bank of Jordan, Annual Report (2006), available at *www.cbj.gov.jo/uploads/annual_table3_e.pdf.*
18. K.M. Kettaneh, Trends of Tax Revenues in Jordan and Effecting Factors, Al-Shabab Publications, Amman, Jordan (1998); The Income Tax Department, Achievements (2006), available at *www.incometax.gov.jo/incometax/main_menue/achievments/*

annaual.aspx.

[19] A.E. Haddad, Accounting Procedures which explains the Differences between Declared and Adjusted Income Tax of Banks in Jordan, unpublished M.Sc. Thesis, Al-al Bayt University, Jordan (on file with the author) (1999).

[20] *In the Shadows; Economics Focus*, THE ECONOMIST (June 19, 2004).

[21] M.H. Abu-Nassar and U. Mubaideen, *Evasion of Income Tax in Jordan*, AL-MANARAH J., Vol. 6 No. 2, at 11 (2000).

[22] M. ABU-NASSAR, M. AL-MASHALEH & F. AL-SHAHWAN, TAXES AND THEIR ACCOUNTING: IN THEORY AND PRACTICE, Ahmed Yaseen Publication Center, Amman, Jordan (2003).

[23] S. Ramadan, T. Al-Hmoud and M. Qaqeesh, *Problems Facing Income Tax Assessors in Jordan*, YARMOUK RESEARCH JOURNAL: HUMANITIES AND SOCIAL SCIENCES SERIES, Vol. 6 No. 4, at 97 (1990); J. Becker, *Fostering Public Confidence in the Tax Profession: An Examination of Ethics and Legal Liability*, J. ACCOUNTING EDUCATION, Vol. 14 No. 1, at 133 (1996).

[24] A.M. Abdel-Rahman, *Comparative Study of Corporate Tax: Prospect for Harmonization in the ESCWA Region*, Document Number E/ESCWA/ED/2000/3, United Nations, Economic and Social Commission for Western Asia, New York, NY (2001).

[25] M. Wenzel, *Motivation or Rationalization? Causal Relations between Ethics, Norms and Tax Compliance*, 26 J. ECONOMIC PSYCHOLOGY 491 (2005); M. Orviska and J. Hudson, *Tax Evasion, Civic Duty and the Law Abiding Citizen*, EUROPEAN J. EUROPEAN ECONOMY, Vol. 19 No. 1, at 83 (2002); L. Grasso and S. Kaplan, *An Examination of Ethical Standards for Tax Issues*, J. ACCOUNTING EDUCATION, Vol. 16 No. 1, at 85 (1998); B. Torgler, *Tax Morale in Asian Countries*, 15 J. ASIAN ECONOMICS 237 (2003).

[26] *Jordan: The Smile Fades*, THE ECONOMIST (July 4, 1998); J. Solomon, *Trouble Next Door: In Jordan, Bombs Highlight Changes Wrought by War—Influx of Iraqis and Their Wealth Bring Growth and Tension To a Key American Ally—Worries at the Textile Plant*, WALL ST. J., at A1 (Nov. 10, 2005).

[27] H. Rasheed, *Financial Asset Declaration: What is the Purpose Behind it?* AL-ARAB AL-YAWM NEWSPAPER (Oct. 11, 2007).

[28] K.E. Abd Al Rahim, *The Tax System in Jordan (1990-1999)*, IRBID J. RESEARCH & STUDIES, at 53 (2001).

[29] Solomon, *supra* note 26.

[30] *Experts Call for Increase in Tax Exemptions for Natural Persons and Elimination of Prison Term for Tax Evasion*, AL RAI NEWSPAPER (July 3, 2006).

[31] *Supra* note 18.

[32] R.C. Feldman, *Consumption Taxes and the Theory of General and Individual Taxation*, 21 VIRGINIA TAX REV. 293 (2002).

[33] G.R. Zorow and C.E. McLure, Jr., *Implementing Direct Consumption Taxes in Developing Countries*, 46 TAX LAW REV. 407 (1991).

[34] S. Al-Shawabkeh, *Evading Income Tax in Jordan*, J. LAW, Vol. 27 No. 4, at 247 (2003).

[35] R. Borck, *Stricter Enforcement May Increase Tax Evasion*, 20 EUROPEAN J. POLITICAL ECONOMY 725 (2004).

[36] H. Al-Zo'bi, *The Effects of Using Information Technology on Improving Work Performance: Case Study of Amman Income Tax Office*, AL-BASAER J., Vol. 10 No. 1, at 107 (2006).

[37] F. Sawalha, *Agenda Proposes Income Tax Revamp*, JORDAN TIMES (Oct. 20, 2005).

[38] *Ministry of Finance Announces Suggested Amendments on the New Law*, AD-DUSTOUR NEWSPAPER (June 16, 2007), at 9.

[39] *Id.*

Announcing ... The NYU 67th Annual Institute on Federal Taxation

The New York University's School of Continuing and Professional Studies is pleased to present its *Institute on Federal Taxation*. Now in its 67th year, the NYU Institute on Federal Taxation has hosted **attorneys, both general tax practitioners and specialists; accountants; corporate treasury and compliance executives; tax managers; and financial planners** seeking expert discussion of the latest technical, legislative, and planning developments. This six-day program encompasses all major areas of tax, including current developments; tax controversies; corporate tax; partnerships, LLCs and real estate; international tax; trusts and estates; executive compensation and employee benefits; elder law; closely held businesses; ethics and hot tax topics. There are over 40 hours of CLE/CPE/CFP credit, including two hours of ethics.

The Institute is designed for the practitioner who must frequently anticipate and handle federal tax matters. It provides high-level updates, practical advice and in-depth analysis of the latest trends and developments from leading experts. Attendees return to work with a wealth of materials, plus the tools and strategies needed to help save clients' tax dollars and provide them with better service. Just as important, the Institute provides the perfect setting to meet practitioners from all around the country. It is an opportunity to share ideas, exchange views, learn what others are doing and **obtain credit for continuing education.**

Participants will have the choice between two destination cities in which to attend the Institute: New York, on October 19–24; and San Diego, on November 9–14. For more information, contact Kathleen Costello at (212) 992-3320 or *kathleen.costello@nyu.edu*, or visit the Web at *www.scps.nyu.edu/splash/ift.html.*