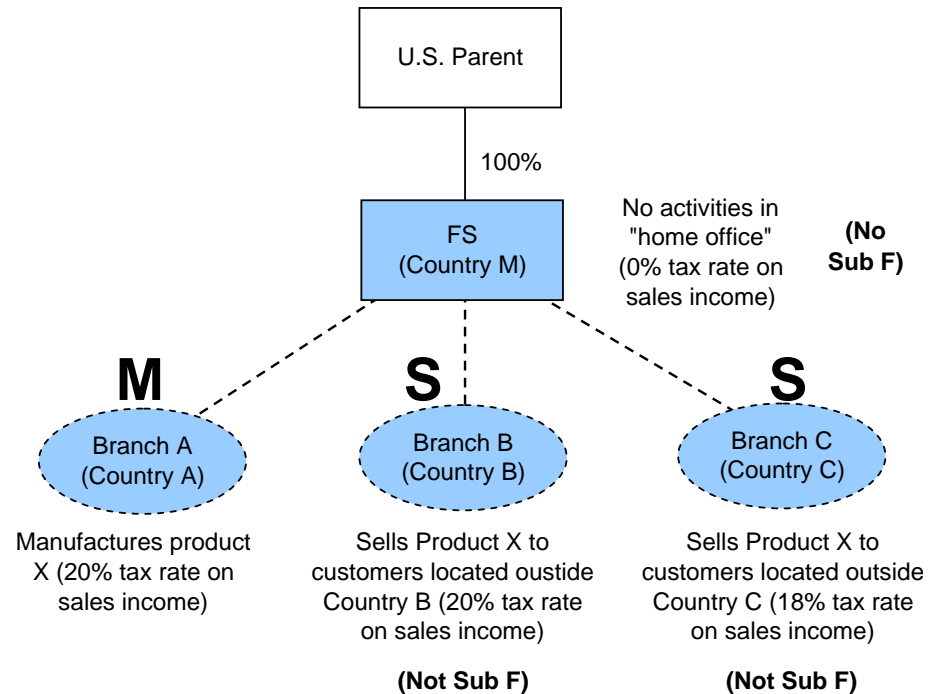


**Temp. Reg. 1.954-3T  
(b)(1)(ii)(c)(1), Ex.**

**One Manufacturing &  
Two Sales Branches  
(No Sub F)**

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FS, a controlled foreign corporation organized under the laws of country M, operates three branches. Branch A, located in country A, manufactures Product X under the principles of Reg.1.954-3(a)(4)(i). Branch B, located in Country B, sells Product X manufactured by Branch A to customers for use outside of Country B. Branch C, located in Country C sells Product X manufactured by Branch A to customers for use outside of Country C. FS does not conduct any manufacturing or selling activities apart from the activities of Branches A, B and C. Country M imposes an effective rate of tax on sales income of 0%. Country A imposes an effective rate of tax on sales income of 20%. Country B imposes an effective rate of tax on sales income of 20%. Country C imposes an effective rate of tax on sales income of 18%.



Reg. 1.954-3(b)(1)(ii)(b) is applied to the sales income derived by Branch B by treating Branch B as though it alone were the remainder of the controlled foreign corporation. The use of Branch B does not have the same tax effect as if Branch B were a wholly owned subsidiary of FS because the tax rate applicable to the income allocated to Branch B (20%) is not less than 90 percent of, and at least 5 percentage points less than, the effective rate of tax which would apply to such income under the laws of Country A (20%), the country in which Branch A is located. Reg. 1.954-3(b)(1)(ii)(b) is applied separately to the sales income derived by Branch C by treating Branch C as though it alone were the remainder of the controlled foreign corporation. The use of Branch C does not have the same tax effect as if Branch C were a wholly owned subsidiary of FS because the tax rate applicable to the income allocated to Branch C (18%) is not less than 90 percent of, and at least 5 percentage points less than, the effective rate of tax which would apply to such income under the laws of Country A (20%), the country in which Branch A is located. The sales branches of Branch B and Branch C are not treated as separate corporations under the branch rules.