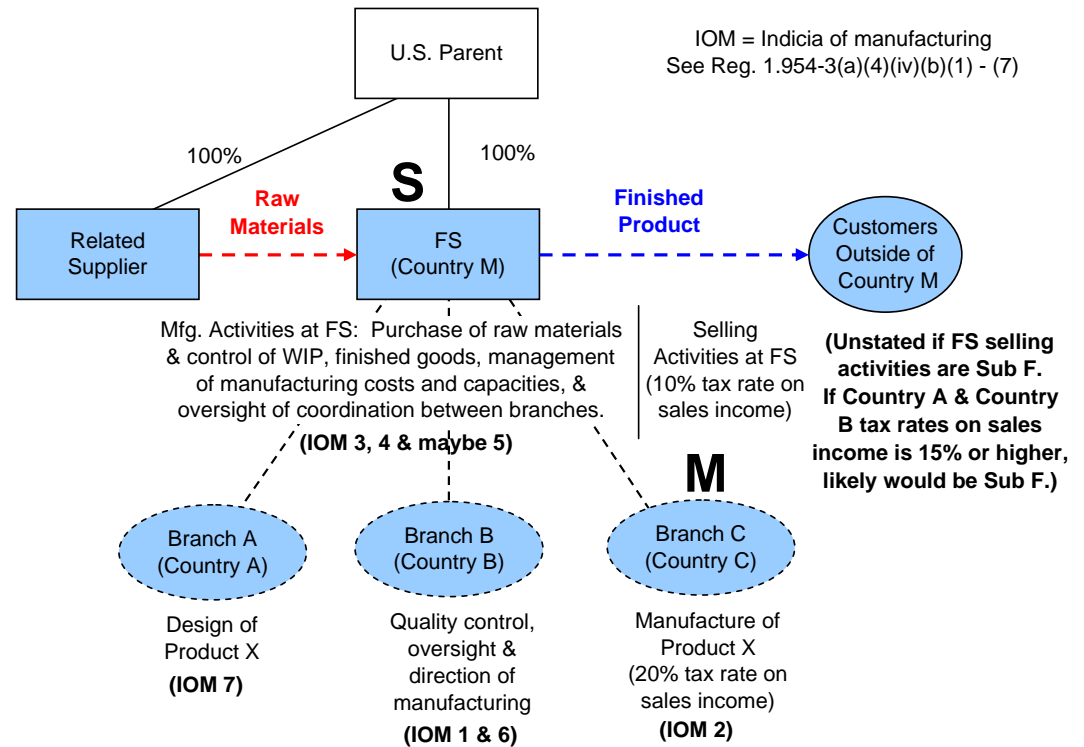


**Temp. Reg. 1.954-3T  
(b)(1)(ii)(c)(3)(v), Example 1**

**Attribution (Or Not) of  
Branch Mfg. Activities**

Copyright © 2009 Andrew Mitchel LLC  
International Tax Services  
www.andrewmitchel.com

FS is a CFC organized in Country M. FS operates three branches, Branch A, Branch B, and Branch C, located respectively in Country A, Country B, and Country C. Branch A, Branch B, and Branch C each performs different manufacturing activities with respect to the manufacture of Product X. Branch A, through the activities of employees of FS located in Country A, designs Product X. Branch B, through the activities of employees of FS located in Country B, provides quality control and oversight and direction. Branch C, through the activities of employees of FS located in Country C, manufactures Product X (within the meaning of Reg. 1.954-3(a)(4)(ii) or (a)(4)(iii)) using the designs developed by Branch A and under the oversight of the quality control personnel of Branch B. The activities of Branch A and Branch B do not independently satisfy Reg. 1.954-3(a)(4)(i). Employees of FS located in Country M purchase the raw materials used in the manufacture of Product X from a related person and control the work-in-process and finished goods throughout the manufacturing process. Employees of FS located in Country M also manage the manufacturing



costs and capacities related to Product X. Further, employees of FS located in Country M oversee the coordination between the branches. The activities of the remainder of FS in Country M do not independently satisfy Reg. 1.954-3(a)(4)(i). Employees of FS located in Country M sell Product X to unrelated persons for use outside of Country M. The sales income from the sale of Product X is taxed in Country M at an effective rate of tax of 10%. Country C imposes an effective rate of tax of 20% on sales income.

Country C is the location of manufacture for purposes of applying Reg. 1.954-3(b)(1)(ii)(b) because only the activities of Branch C independently satisfy Reg. 1.954-3(a)(4)(i). The use of Branch C has substantially the same tax effect as if Branch C were a wholly owned subsidiary corporation of FS because the effective rate of tax on the sales income in Country M (10%) is less than 90% of, and at least 5 percentage points less than, the effective rate of tax that would apply to such income in Country C, the country in which Branch C is located (20%). Therefore, sales of Product X by the remainder of FS are treated as sales on behalf of Branch C. In determining whether the remainder of FS will qualify for the manufacturing exception under Reg. 1.954-3(a)(4)(iv), the activities of FS will include the activities of Branch A or Branch B, respectively, if each of those branches would not be treated as a separate corporation under Reg. 1.954-3(b)(1)(ii)(b), if that paragraph were applied independently to each of Branch A and Branch B.