



Controlled foreign corporation E, incorporated under the laws of foreign country X, is a wholly owned subsidiary of controlled foreign corporation D, also incorporated under the laws of country X. Corporation E maintains branch B in foreign country Y. In 1964, E Corporation's sole activity, carried on through branch B, consists of the purchase of articles manufactured in country X by D Corporation, a related person, and the sale of the articles through branch B for use outside country X. The income of E Corporation derived by branch B from such transactions is taxed to E Corporation by country X only at the time E Corporation distributes such income to D Corporation and is then taxed on the basis of what the tax (a 40% effective rate) would have been if the income had been derived in 1964 by E Corporation from sources within country X from doing business through a permanent establishment therein. Country Y levies an income tax at an effective rate of 50% on income derived from sources within such country, but the income of branch B for 1964 is effectively taxed by country Y at a 5% rate since, under the laws of such country, only 10 percent of branch B's income is derived from sources within such country. Corporation E makes no distributions to D Corporation in 1964. In determining foreign base company sales income of E Corporation for 1964, branch B is treated as a separate wholly owned subsidiary corporation of E Corporation, the 5% rate of tax on branch B's income being less than 90% of, and at least 5 percentage points less than, the 40% rate. Income derived by branch B, treated as a separate corporation, from the sale by or through it for use, consumption, or disposition outside country Y of the personal property produced in country X is treated as income from the sale of personal property on behalf of E Corporation, a related person, and constitutes foreign base company sales income.