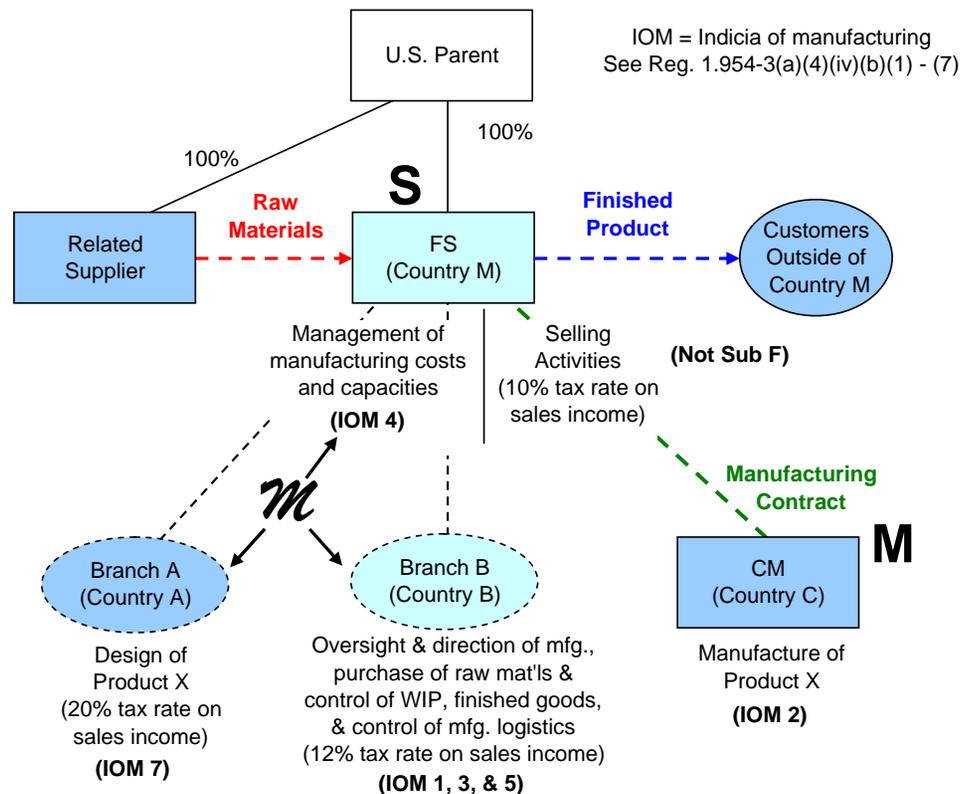


**Temp. Reg. 1.954-3T
(b)(1)(ii)(c)(3)(v), Example 4**

**Home Office & Low Rate Branch
Demonstrably Greater, Than High Rate Branch**

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

FS, a controlled foreign corporation organized in Country M, purchases raw materials from a related person. The raw materials are manufactured (under the principles of Reg. 1.954-3(a)(4)(ii) or (a)(4)(iii)) into Product X by CM, an unrelated corporation, pursuant to a contract manufacturing arrangement. CM physically performs the substantial transformation, assembly, or conversion of the raw materials in Country C. FS has two branches, Branch A and Branch B, located in Country A and Country B respectively. 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, controls manufacturing related logistics, provides oversight and direction during the manufacturing process, and controls the raw materials and work-in-process. FS manages the manufacturing costs and capacities related to the manufacture of Product X through employees located in Country M. Further, employees of FS located in Country M oversee the coordination between the branches. Employees of FS located in Country M also sell Product X to unrelated persons for use outside of Country M. Country M imposes an effective rate of tax on sales income of 10%. Country A imposes an effective rate of tax on sales income of 20%, and Country B imposes an effective rate of tax on sales income of 12%. Neither the remainder of FS, nor any branch of FS independently satisfies Reg. 1.954-3(a)(4)(i). However, under the facts and circumstances of the business, FS as a whole provides a substantial contribution to the manufacture of Product X within the meaning of Reg. 1.954-3(a)(4)(iv). The activities of employees of FS located in Country B and Country M, if considered together, would provide a demonstrably greater contribution to the manufacture of Product X than the activities of employees of FS located in Country A.



Based on the facts, neither the remainder of FS (through activities of its employees in Country M) nor any branch of FS independently satisfies Reg. 1.954-3(a)(4)(i) with respect to Product X, but FS, as a whole, provides a substantial contribution through the activities of its employees to the manufacture of Product X. The remainder of FS, Branch A, and Branch B each provide a contribution through the activities of their employees to the manufacture of Product X. Therefore, FS must determine the location of manufacture under Temp. Reg. 1.954-3T(b)(1)(ii)(c)(3)(iii). The tested sales location is Country M because the selling activities with respect to Product X are carried on by the remainder of FS. The location of Branch A is the tested manufacturing location because the effective rate of tax imposed on FS's sales income by 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 A (20%), and Branch A is the only branch that would, after applying Reg. 1.954-3(b)(1)(ii)(b), be treated as a separate corporation. The activities of Branch B will be included in the contribution of the remainder of FS for purposes of determining the location of manufacture of Product X because the effective rate of tax imposed on the sales income by Country M (10%) is not 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 B (12%). Under a facts and circumstances analysis, considered together, the activities of Branch B and the remainder of FS would provide a demonstrably greater contribution to the manufacture of Product X than the activities of Branch A. Therefore, the rules of Temp. Reg. 1.954-3T(b)(1)(ii)(a) will not apply with respect to the income derived by the remainder of FS in connection with the sale of Product X, and neither Branch A nor Branch B will be treated as a separate corporation for purposes of Temp. Reg. 1.954-3T(b)(2)(ii) and Reg. 1.954-3(b)(2)(ii).