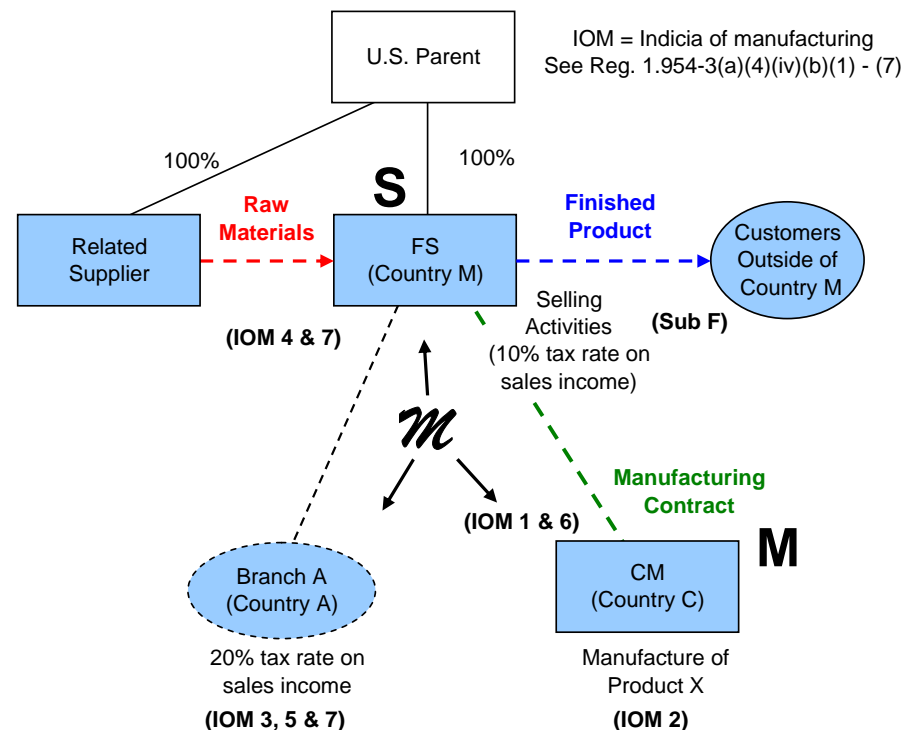


**Temp. Reg. 1.954-3T
(b)(1)(ii)(c)(3)(v), Example 6**

**Location of Manufacture When
Employees Travel to CM (Sub F)**

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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. Employees of FS located in Country M sell Product X to unrelated persons for use outside of Country M. Employees of FS located in Country M engage in product design, manage the manufacturing costs and capacities with respect to Product X, and direct the use of intellectual property for the purpose of manufacturing Product X. Quality control and oversight and direction of the manufacturing process are conducted in Country C by employees of FS who are employed in Country M but who regularly travel to Country C. Branch A, located in Country A, is the only branch of FS. Product design with respect to Product X conducted by employees of FS located in Country A is supplemental to the bulk of the design work, which is done by employees of FS located in Country M. At all times, employees of Branch A control the raw materials, work-in-process and finished goods. Employees of FS located in Country A also control manufacturing related logistics with respect to Product X. 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%. Neither the remainder of FS nor Branch A independently satisfies Reg. 1.954-3(a)(4)(i). However, under the facts and circumstance of the business, FS as a whole (including Branch A) provides a substantial contribution to the manufacture of Product X within the meaning of Reg. 1.954-3(a)(4)(iv).



Based on the facts, neither the remainder of FS nor Branch A 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 and Branch A each provide a contribution through the activities of employees to the manufacture of Product X. Therefore, FS must determine the location of manufacture under Reg. 1.954-3(b)(1)(ii)(c)(3)(iii). The tested sales location is Country M because the remainder of FS performs the selling activities with respect to Product X. The tested manufacturing location is the location of Branch A because the effective rate of tax imposed on the remainder of 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. Although the activities of traveling employees are considered in determining whether FS, as a whole, makes a substantial contribution to the manufacture of Product X under Reg. 1.954-3(a)(4)(iv), the activities of the employees of FS that are performed in Country C are not taken into consideration in determining whether Country M, the jurisdiction under the laws of which FS is organized, is the location of manufacture under paragraph Reg. 1.954-3(b)(1)(ii)(c)(3)(iii). Activities of employees performed outside the jurisdiction in which the controlled foreign corporation is organized and outside a location in which the controlled foreign corporation maintains a branch or similar establishment, are not considered in determining the location of manufacture. Under the facts and circumstances of the business, the activities of employees of FS performed in Country M do not provide a demonstrably greater contribution to the manufacture of Product X than the activities of employees of FS performed in Country A. Therefore, the location of manufacture is Country A, the location of Branch A.

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