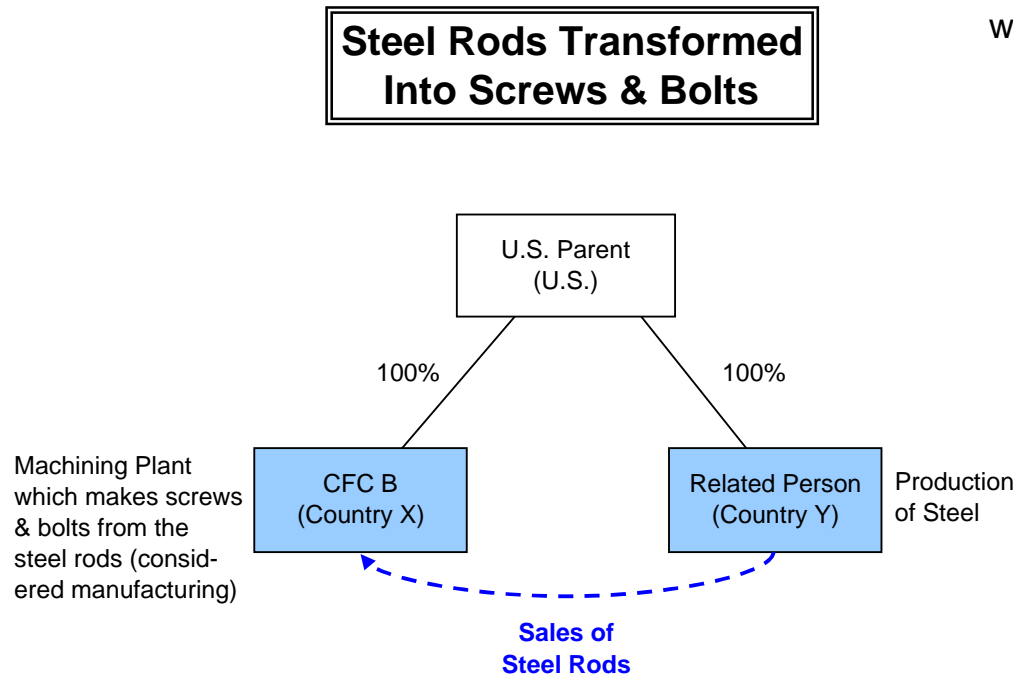


Reg. 1.954-3(a)(4)(ii), Example 2

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Controlled foreign corporation B, incorporated under the laws of foreign country X, purchases steel rods from a related person which produces the steel in foreign country Y. Corporation B operates a machining plant in country X in which it utilizes the purchased steel rods to make screws and bolts. The transformation of steel rods to screws and bolts constitutes the manufacture or production of property. **Because CFC B is manufacturing, its income is not foreign base company sales income.**

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