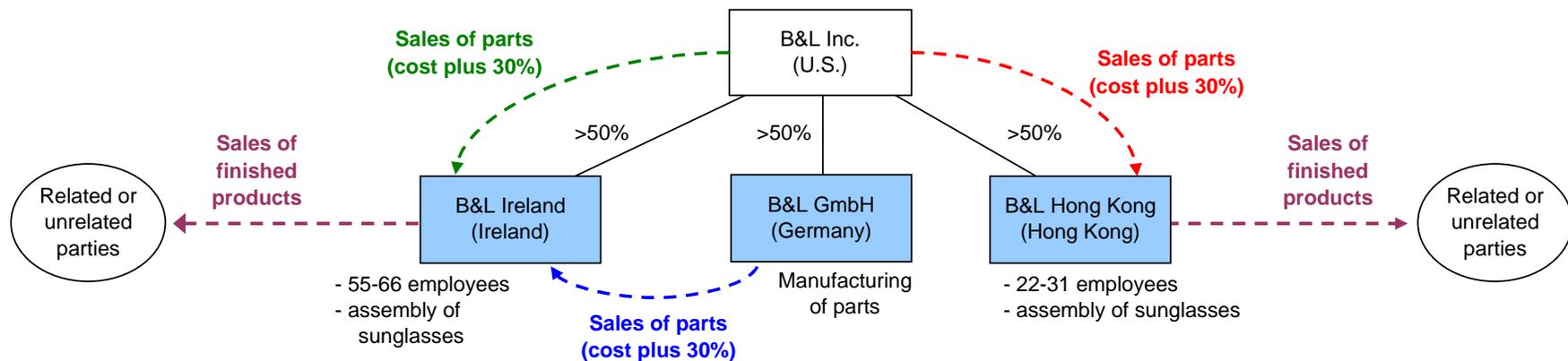


**Bausch & Lomb Inc.
v. Commissioner
71 TCM 2031 (1996)**

**Assembly of Sunglasses Was Not
Foreign Base Company Sales Income**

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The legislative history of subpart F provides some guidance on the meaning of foreign base company sales income. In its explanation of subpart F, the Senate Finance Committee stated:

The "foreign base company sales income" referred to here means income from the purchase and sale of property, without any appreciable value being added to the product by the selling corporation. This does not, for example, include cases where any significant amount of manufacturing, major assembling, or construction activity is carried on with respect to the product by the selling corporation. On the other hand, activity such as minor assembling, packaging, repackaging or labeling will not be sufficient to exclude the profits from this definition. The sales income with which your committee is primarily concerned is income of a selling subsidiary (whether acting as principal or agent) which has been separated from manufacturing activities of a related corporation merely to obtain a lower rate of tax for the sales income.

In their technical explanations of the bill enacting subpart F, both the Senate Finance Committee and the House Ways and Means Committee further explained that the definition of "foreign base company sales income":

does not apply to income of a controlled foreign corporation from the sale of a product which it manufactures. In a case in which a controlled foreign corporation purchases parts or materials which it then transforms or incorporates into a final product, income from the sale of the final product would not be foreign base company sales income if the corporation substantially transforms the parts or materials, so that, in effect, the final product is not the property purchased. Manufacturing and construction activities (and production, processing, or assembling activities which are substantial in nature) would generally involve substantial transformation of purchased parts or materials.

The Court referred to the requirement that the operations conducted be substantial in nature and be generally considered to constitute the manufacture of a product as the "facts and circumstances" test and the requirement that the conversion costs be equal to 20% of the total cost of goods sold as the "mechanical" test. See Reg. 1.954-3(a)(4)(iii). The Court found that the Ireland and Hong Kong operations satisfy the facts and circumstances test. Although the sunglass assembly operations did not require a large investment in physical capital, the operations required a substantial investment in human capital in order to produce quality sunglasses.

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