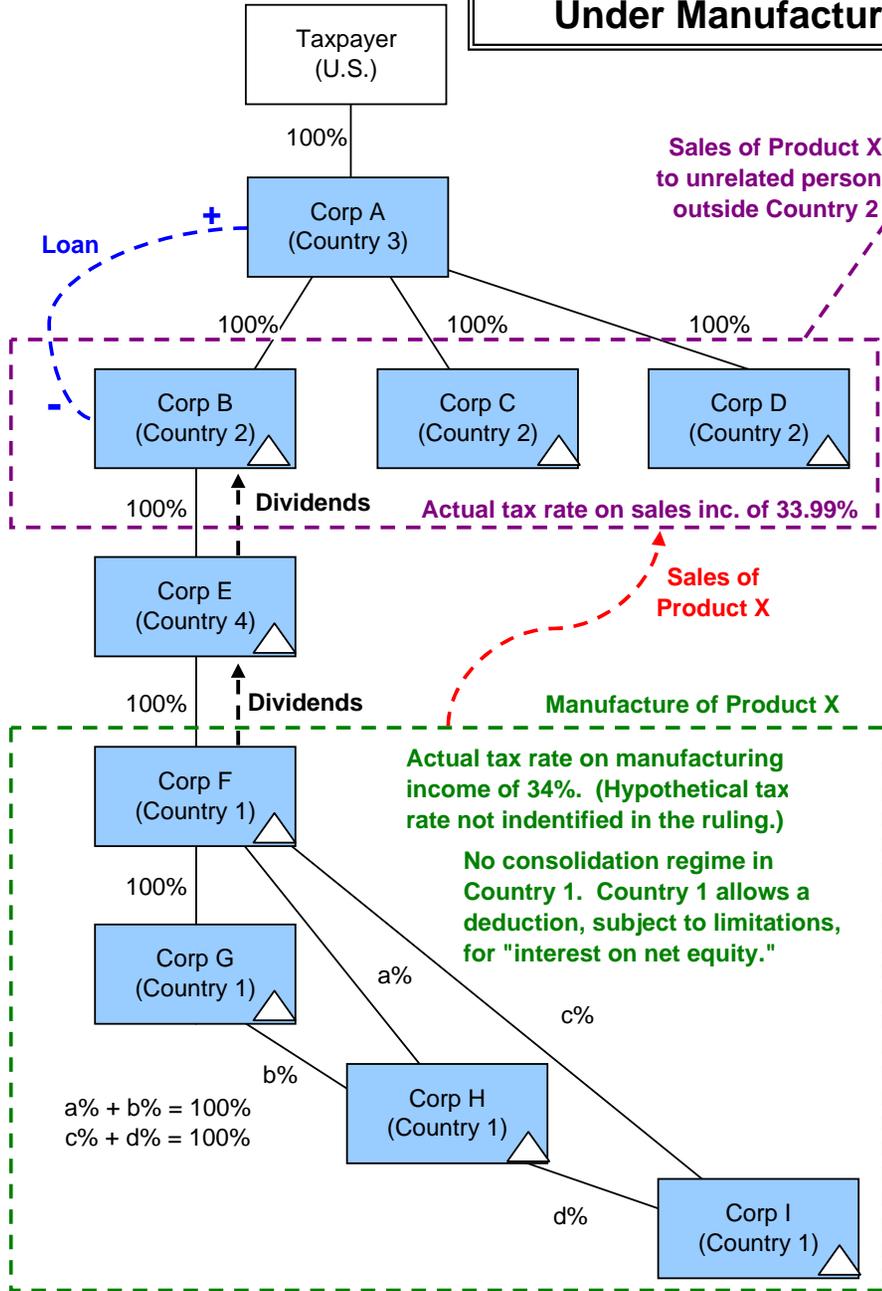


# Local Law Used For Tax Rate Calculations Under Manufacturing Branch Rule



For purposes of determining the effective rate of tax to which the sales income derived by Corporation B is subject under Treas. Reg. §1.954-3(b)(1)(ii)(c), the effective rate of tax is determined by applying local law. The effective rate of tax in Country 2 with regards to Corporation B is calculated by taking the Country 2 income taxes paid by Corporation B attributable to its FBCSI, which may require adjustments to allocate or apportion expenses in accordance with the laws of Country 2. This will include the allocation or apportionment of Corporation B's interest expense between its income categories in accordance with Country 2 tax law. Thus, Corporation B will compute its Country 2 income tax liability with respect to the sales income taking into account its items of expense or deduction, including deductions attributable to interest on the note held by Corporation A.

For purposes of determining the hypothetical effective rate of tax to which the income derived by Corporation B would be subject under Treas. Reg. §1.954-3(b)(1)(ii)(b) and (c) one must divide the hypothetical income tax that would have been imposed on an item of FBCSI by the item of FBCSI taking into account all deductions properly allocable thereto. Under Treas. Reg. §1.954-3(b)(1)(ii)(c) the Country 2 branch should be treated as a separate CFC for purposes of applying the tax rate disparity test of the branch rule. Also, Treas. Reg. §1.954-3(b)(2)(i)(e) provides that tax determinations shall be made by taking into account only the income, war profits, excess profits, or similar tax laws of the countries involved. The hypothetical effective rate of tax is computed by considering the deductions available under the local law to which the sales income of Corporation B is hypothetically superimposed. Consequently, the Country 1 deductions for interest on net equity, if any, as well as other deductions that are reasonably allocated and apportioned to Corporation B's FBCSI are considered when calculating the hypothetical rate of tax to the extent that these deductions are currently available in Country 1. However, this hypothetical calculation is an annual event, and Taxpayer may only account for the special deduction in a year that a qualifying distribution has been distributed.

△ Flow-thru for U.S. tax purposes