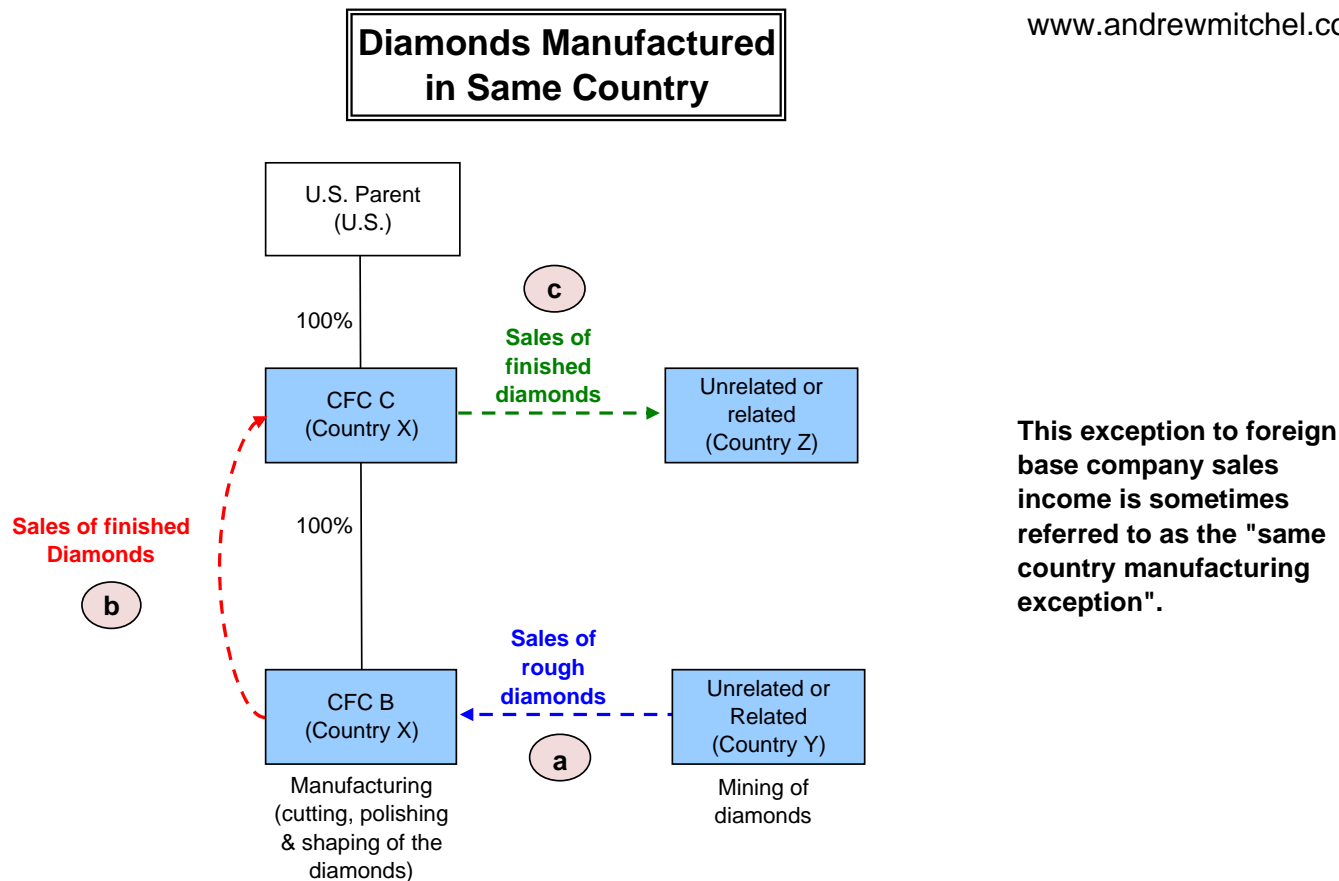


Reg. 1.954-3(a)(2), Example 2

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This exception to foreign base company sales income is sometimes referred to as the "same country manufacturing exception".

Controlled foreign corporation B, incorporated under the laws of foreign country X, is a wholly owned subsidiary of controlled foreign corporation C, also incorporated under the laws of country X. Corporation B purchases and imports into country X rough diamonds mined in foreign country Y; in country X Corporation B cuts, polishes, and shapes the diamonds in a process which constitutes manufacturing. Corporation B sells the finished diamonds to C Corporation, a related person, which in turn sells them for use in foreign country Z. Since the finished diamonds are manufactured in country X, **gross income derived by C Corporation from their sale is not foreign base company sales income**.