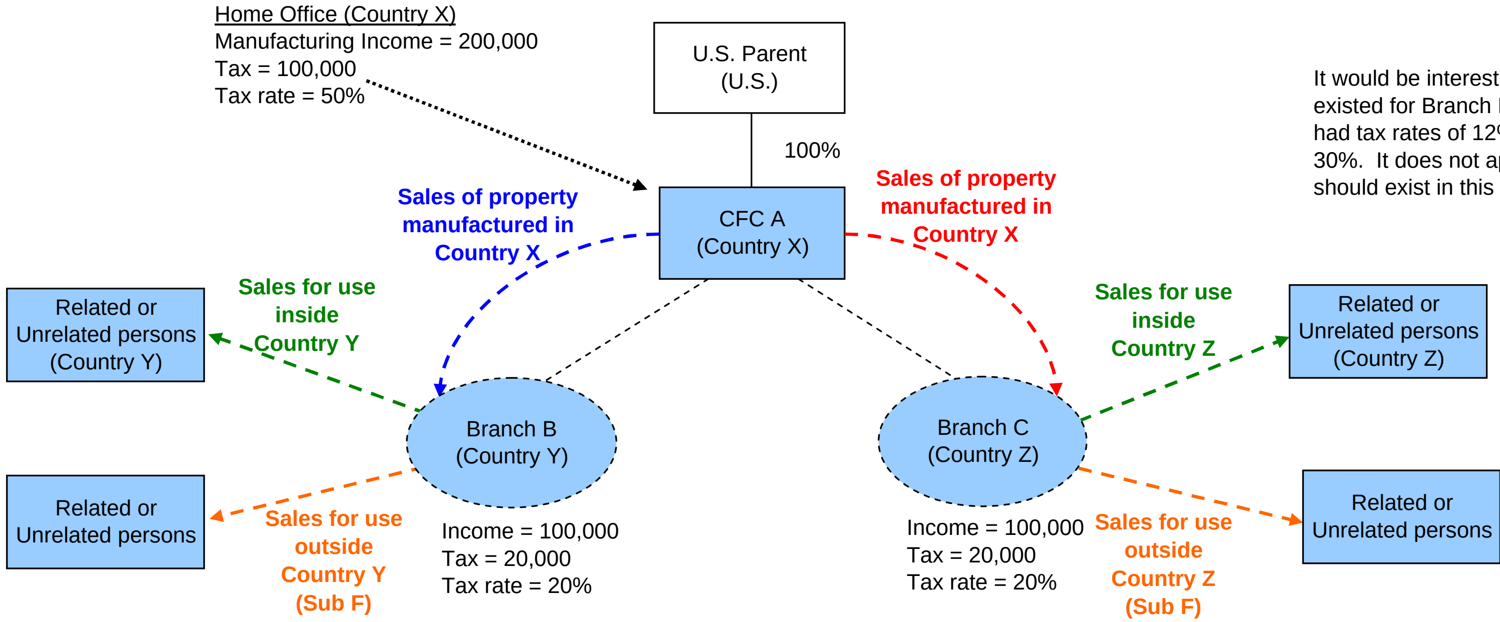
Reg. 1.954-3(b)(4), Example 5

Multiple Sales Branches With Tax Rate Differentials

It would be interesting to see if a tax rate differential existed for Branch B if the home office and Branch B had tax rates of 12% but Branch C had a tax rate of 30%. It does not appear that a tax rate differential should exist in this case.



A tax rate differential exists for Branch B (or Branch C) if the tax on Branch B (or Branch C) activities is less than 45% [lesser of 90% of 50% (45%) or 50% - 5% (45%)].

Controlled foreign corporation A, incorporated under the laws of foreign country X, is engaged in manufacturing articles through its home office, located in country X, and selling such articles through branch B, located in foreign country Y, and through branch C, located in foreign country Z, for use outside country X. These activities constitute the only activities of A Corporation for its taxable year 1963. Each such country levies an income tax on only the income derived from sources within such country, and all income derived in 1963 by the home office, branch B, and branch C, respectively, is derived from sources within countries X, Y, and Z, respectively.

By treating branch B as though it were the only branch of A Corporation, branch B is treated as a separate wholly owned subsidiary corporation of A Corporation in determining foreign base company sales income of A Corporation. This separate treatment occurs because the 20% rate of tax on the income of branch B is less than 90% of, and at least 5 percentage points less than, the 50% rate of tax which would apply to the income of branch B under the laws of country X if all the income of A Corporation derived through the home office and branch B were derived from sources within country X. Moreover, by treating branch C as though it were the only branch of A Corporation, branch C is treated as a separate wholly owned subsidiary corporation of A Corporation. This separate treatment occurs because the 20% rate of tax on the income of branch C is less than 90% of, and at least 5 percentage points less than, the 50% rate of tax which would apply to the income of branch C under the laws of country X if all the income of A Corporation derived through the home office and branch C were derived from sources within country X. The income derived from the sale by or through branch B, treated as a separate corporation, for use or consumption outside country Y is treated as income from the sale of personal property on behalf of A Corporation, a related person, and constitutes foreign base company sales income. The income derived from the sale by or through branch C, treated as a separate corporation, for use or consumption outside country Z is treated as income from the sale of personal property on behalf of A Corporation, a related person, and constitutes foreign base company sales income. The home office of A Corporation, treated as a separate corporation, derives no foreign base company sales income since it produces the articles which are sold.