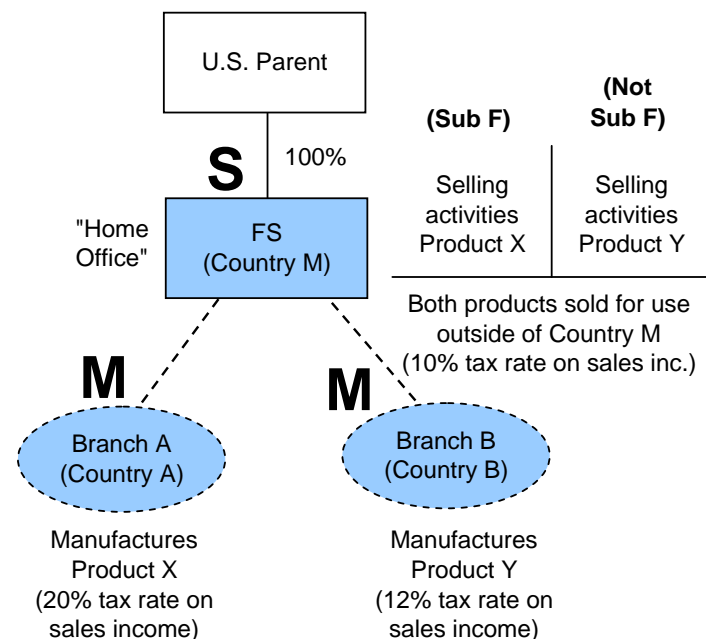


**Temp. Reg. 1.954-3T  
(b)(1)(ii)(c)(2), Ex.**

**Two Manufacturing Branches:  
Separate Items (Some Sub F)**

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FS is a controlled foreign corporation organized in Country M. FS operates two branches, Branch A and Branch B located in Country A and Country B, respectively. Branch A and Branch B each manufacture separate items of personal property (Product X and Product Y, respectively) within the meaning of Reg. 1.954-3(a)(4)(ii) or (iii). Raw materials used in the manufacture of Product X and Product Y are purchased by FS from an unrelated person. FS engages in activities in Country M to sell Product X and Product Y to a related person for use, disposition or consumption outside of Country M. Employees of FS located in Country M perform only sales functions. The effective rate of tax imposed in Country M on the income from the sales of Product X and Product Y is 10%. Country A imposes an effective rate of tax on sales income of 20%. Country B imposes an effective rate of tax on sales income of 12%.



Reg. 1.954-3(b)(1)(ii)(b) is applied separately to Branch A and Branch B with respect to the sales income of FS attributable to Product X (manufactured by Branch A) and Product Y (manufactured by Branch B). Because the effective rate of tax on FS's sales income from the sale of Product X in Country M (10%) is less than 90% of, and at least 5 percentage points less than, the effective rate of tax that would apply to such income in the country in which Branch A is located (20%), the use of Branch A to manufacture Product X has substantially the same tax effect as if Branch A were a wholly owned subsidiary corporation of FS. Because the effective rate of tax on FS's sales income from the sale of Product Y in Country M (10%) is not less than 90% of, and at least 5 percentage points less than, the effective rate of tax that would apply to such income in the country in which Branch B is located (12%), the use of Branch B to manufacture Product Y does not have substantially the same tax effect as if Branch B were a wholly owned subsidiary corporation of FS. Consequently, only Branch A, and not Branch B, is treated as a separate corporation apart from the remainder of FS for purposes of determining foreign base company sales income from the sales of Product X.

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