Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
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Person To Contact:
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Telephone Number:

Refer Reply To:

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Date:
October 02, 2009

In Re:

LEGEND

Taxpayer	=
Corporation A	=
Corporation B	=
Corporation C	=
Corporation D	=
Corporation E	=
Partnership 1	=
Partnership 2	=
Disregarded Entity 1	=
Disregarded Entity 2	=
Disregarded Entity 3	=
Disregarded Entity 4	=
Disregarded Entity 5	=
Disregarded Entity 6	=
Disregarded Entity 7	=
Country 1	=
Country 2	=
Country 3	=
Country 4	=
Country 5	=
Country 6	=
Country 7	=
Country 8	=
a percent	=
b percent	=
c percent	=
Date 1	=
Date 2	=
Product X	=

a dollars =

Dear :

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

This ruling is in response to a letter dated June 2, 2009, in which you requested a ruling that Corporation C's distributive share of income from Partnership 2 will not constitute foreign base company sales income pursuant to sections 954(d)(1) and 954(d)(2) of the Internal Revenue Code ("Code").

FACTS

Taxpayer is a U.S. corporation that conducts activities directly and through domestic and foreign subsidiaries, and holds various joint venture interests including partnerships through U.S. and foreign corporations.

Taxpayer owns 100% of the issued and outstanding shares of Corporation A, a U.S. corporation and member of Taxpayer's consolidated group. Corporation A holds 100% of the issued and outstanding shares of Corporation B located in Country 1. Corporation B owns 100% of the issued and outstanding shares of Corporation C located in Country 1. Corporation C owns 100% of the issued and outstanding shares of Corporation D located in Country 2. Corporation D has elected to be treated as an entity disregarded as separate from its owner for U.S. federal income tax purposes.

On Date 1 Taxpayer, Corporation E (an unrelated publicly traded corporation established under the laws of Country 3), and Partnership 1 (an unrelated U.S. based investment consortium) agreed to form an independent group of companies (hereinafter the "Business Group"). The Business Group is held through and includes Partnership 2 (located in Country 3), which has elected to be treated as a partnership for U.S. federal income tax purposes.

The Business Group was formed for the purpose of manufacturing and selling Product X. The manufacture of Product X is divisible into two distinct phases which occur at separate facilities. In the first phase, raw materials are used to produce fabricated Product X. In the second phase, fabricated Product X is assembled and tested to produce finished Product X.

On Date 2 Taxpayer contributed and assigned assets from an existing business in exchange for an a percent ownership interest in Partnership 2. The majority of

Taxpayer's equity interest in Partnership 2 is held by Corporation D. However, because Corporation D is treated as a branch or division of Corporation C for U.S. federal income tax purposes, Corporation C is treated as the owner of Corporation D's interest in Partnership 2. Corporation E contributed assets from an existing business in exchange for a b percent ownership interest in Partnership 2. Partnership 1 contributed a dollars in exchange for a c percent ownership interest in Partnership 2.

Partnership 2 owns 100% of the issued and outstanding shares of Disregarded Entity 1. Disregarded Entity 1 is organized under the laws of Country 3 and has elected to be treated as an entity disregarded as separate from its owner for U.S. federal income tax purposes.

Disregarded Entity 1 is headquartered in Country 4, where most Business Group corporate officers reside. Because Disregarded Entity 1 is disregarded for U.S. federal income tax purposes, the headquarters are considered a Country 4 branch of Partnership 2 (hereinafter the “Country 4 Branch”). The Country 4 Branch is the main operating company for the Business Group. It engages in the purchase and sale of fabricated and finished Product X with Taxpayer and Business Group members.

Disregarded Entity 1 holds all of the issued and outstanding shares of numerous entities, including:

- Disregarded Entity 2 located in Country 5
- Disregarded Entity 3 located in Country 2
- Disregarded Entity 4 located in Country 6
- Disregarded Entity 5 located in Country 7
- Disregarded Entity 6 located in Country 2
- Disregarded Entity 7 located in Country 8

Under an agreement with the Country 4 government, the Country 4 Branch is subject to a 0% income tax.

Taxpayer owns and operates a Product X fabrication facility located in the U.S. Taxpayer sells fabricated Product X from its facility, as well as fabricated Product X it purchases from an indirectly and wholly owned subsidiary, to the Country 4 Branch.

Disregarded Entity 2 owns and operates a Product X fabrication facility located in Country 5 and sells fabricated Product X to the Country 4 Branch. Under an agreement with the Country 5 government, Disregarded Entity 2 is subject to an effective tax rate of 10%.

Disregarded Entity 3 owns and operates a Product X fabrication facility located in Country 2 and sells fabricated Product X to the Country 4 Branch. Under an agreement

with the Country 2 government, Disregarded Entity 3 is subject to an effective income tax rate of 5%.

Disregarded Entity 4 owns and operates a Product X fabrication facility located in Country 6 and sells fabricated Product X to the Country 4 Branch. Under an agreement with the Country 6 government, Disregarded Entity 4 is subject to an effective income tax rate of 25%.

Disregarded Entity 5 owns and operates a Product X assembly and testing facility located in Country 7. Fabricated Product X is assembled, tested, and packaged for sale to customers as finished Product X. The assembly and testing activities performed by Disregarded Entity 5 are substantial and are generally considered to constitute manufacturing for purposes of Treas. Reg. § 1.954-3(a)(4)(iii). Under an agreement with Country 7, Disregarded Entity is subject to an effective income tax rate of 0%.

Disregarded Entity 6 is headquartered in Country 2 and sells finished Product X to unrelated customers throughout the world. Under an agreement with the Country 2 government, Disregarded Entity 6 is subject to an effective income tax rate of 18%.

Disregarded Entity 7 is headquartered in Country 8 and sells finished Product X to unrelated customers primarily in Country 8. Disregarded Entity 7 is subject to an effective income tax rate of approximately 35%.

Corporation C is subject to an effective income tax rate of 0% in its country of incorporation.

The Country 4 Branch purchases fabricated Product X from Taxpayer, Disregarded Entity 2, Disregarded Entity 3, and Disregarded Entity 4, and resells the fabricated Product X to Disregarded Entity 5 for assembly and testing. Upon completion of the assembly and testing, Disregarded Entity 5 sells finished Product X to the Country 4 Branch. The Country 4 Branch sells the finished Product X to unrelated customers and/or to Disregarded Entity 6 and Disregarded Entity 7 for direct sales to unrelated customers.

RULING REQUESTED

Taxpayer requests a ruling that Corporation C's distributive share of income from Partnership 2 that is attributable to sales of Product X assembled and tested by Disregarded Entity 5 does not constitute foreign base company sales income ("FBCSI") pursuant to sections 954(d)(1) and 954(d)(2) of the Code.

LAW

Section 957(a) defines a controlled foreign corporation ("CFC") as any foreign corporation if more than 50 percent of the total combined voting power of all classes of stock of such corporation entitled to vote or the total value of the stock of such corporation is owned or considered owned by U.S. shareholders on any day during the taxable year of such foreign corporation.

Section 951(b) defines a U.S. shareholder, with respect to any foreign corporation, as a U.S. person who owns or is considered to own 10 percent or more of the total combined voting power of all classes of stock entitled to vote of such foreign corporation.

Sections 958(a) and 958(b) provide that stock owned directly, indirectly, and constructively must be taken into account. Section 958(a)(1)(B) provides that shareholders or partners of a foreign entity are treated as actually owning foreign corporation stock that is held by that foreign entity. Section 958(a)(2) states that the amount of foreign corporation stock treated as indirectly owned is determined based on the shareholder's or partner's proportionate ownership interest in the foreign entity which owns the foreign corporation stock. Treas. Reg. § 1.958-1(c)(2) states that the determination of a shareholder's or partner's proportionate ownership interest in a foreign entity for purposes of sections 951(b) and 957 will be determined based on all the facts and circumstance but that it will generally be made with reference to the amount of voting power such person owns in the foreign entity. Section 958(b) indicates that the constructive stock ownership rules of section 318(a), with certain qualifications, will apply to determine ownership under section 951(b).

Section 951(a)(1)(A)(i) states that a U.S. shareholder must include in gross income its pro rata share of subpart F income. Section 952(a)(2) states that subpart F income includes foreign base company income. Section 954(a)(2) states that foreign base company income includes foreign base company sales income ("FBCSI") as defined under section 954(d). FBCSI under section 954(d)(1) includes: (1) income from the CFC's purchase of personal property from a related person and the subsequent sale of such personal property to any person; (2) income from the CFC's sale to a related person of personal property purchased from any person; (3) income from the CFC's sale of personal property to any person on behalf of a related person; and (4) income from the CFC's purchase of personal property from any person on behalf of a related person.

Section 954(d)(3) states that a person is a related person with respect to a CFC if: (1) such person is an individual, corporation, partnership, trust, or estate which controls, or is controlled by, the CFC; or (2) such person is a corporation, partnership, trust, or estate which is controlled by the same person or persons which control the CFC. The section defines control as direct or indirect ownership of more than 50 percent of the total voting power of all classes of stock entitled to vote or the total value of a corporation or more than 50 percent of the beneficial interest in a partnership.

Additionally, the same attribution rules of section 958 for determining ownership also apply when determining control.

Treas. Reg. § 1.952-1(g)(1) states that a CFC's distributive share of any item of partnership income is income that falls within a category of subpart F income described in section 952(a) to the extent the item of income would have been income in such category if received by the CFC directly.

Treas. Reg. § 1.954-1(g)(1) states that, unless otherwise provided, to determine the extent to which a CFC's distributive share of any item of gross income of a partnership would have been subpart F income if received by it directly, if a provision of subpart F requires a determination of whether an entity is a related person, within the meaning of section 954(d)(3), or whether an activity occurred within or outside the country under the laws of which the CFC is created or organized, this determination shall be made by reference to the CFC and not by reference to the partnership.

Treas. Reg. § 1.954-3(a)(4)(i) provides that FBCSI does not include income of a CFC derived in connection with the sale of personal property manufactured, produced, or constructed ("manufactured") by such corporation in whole or in part from personal property which it has purchased. Treas. Reg. § 1.954-3(a)(4)(ii) provides that if purchased personal property is substantially transformed prior to sale then that property will be treated as having been manufactured by the selling corporation. Treas. Reg. § 1.954-3(a)(4)(iii) provides that if purchased property is used as a component of property that is sold, and the operations conducted by the selling corporation in connection with the property purchased and sold are substantial in nature and generally considered to constitute the manufacture of property, then the sale of the property will be treated as the sale of a manufactured product. Additionally, Treas. Reg. § 1.954-3(a)(4)(iii) includes a safe harbor that provides that the operations of the selling corporation in connection with the use of the purchased property as a component part of the personal property which is sold will be considered to constitute the manufacture of a product if in connection with such property conversion costs of such corporation account for at least 20 percent of the cost of goods sold.

Treas. Reg. § 1.954-3(a)(6) states that to determine the extent to which a CFC's distributive share of any item of income of a partnership would have been FBCSI if received by it directly, the property sold will be considered to be manufactured by the CFC only if the manufacturing exception of Treas. Reg. § 1.954-3(a)(4) would have applied to exclude the income from FBCSI if the CFC had earned the income directly, determined by taking into account only the activities of, and property owned by, the partnership and not the separate activities or property of the CFC or any other person.

Section 954(d)(2) states that when the carrying on of activities by a CFC through a branch or similar establishment ("branch") outside the country of incorporation of the CFC has substantially the same effect as if such branch were a wholly owned

subsidiary corporation deriving such income, under regulations prescribed by the Secretary the income attributable to the carrying on of such activities of such branch shall constitute FBCSI.

Treas. Reg. § 1.954-3(b)(1)(ii)(a) provides that if a CFC carries on manufacturing by or through a branch located outside the country under the laws of which the CFC is created or organized and the use of such branch for such activities with respect to personal property purchased or sold by or through the remainder of the CFC has substantially the same tax effect as if the branch were a wholly owned subsidiary corporation of the CFC then the branch and the remainder of the CFC will be treated as separate corporations for purposes of determining FBCSI of the CFC.

Treas. Reg. § 1.954-3(b)(1)(ii)(b) provides that use of a manufacturing branch will have substantially the same tax effect as if the branch were a wholly owned subsidiary corporation of the CFC if income allocated to the remainder of the CFC is taxed in the year when earned at an effective rate of tax that is less than 90% of, and at least 5 percentage points less than, the effective rate of tax which would apply to such income under the laws of the country in which the branch is located, if, under the laws of such country, the entire income of the CFC were considered derived by the CFC from sources within such country from doing business through a permanent establishment therein, received in such country, and allocable to such permanent establishment, and the corporation were created or organized under the laws of, and managed and controlled in, such country (hereinafter referred to as “tax rate disparity”).

Treas. Reg. § 1.954-3(b)(1)(ii)(c) provides that where a CFC carries on manufacturing by or through a branch located outside the country under the laws of which the CFC is created or organized, and also carries on purchasing or selling activities by or through one or more branches located outside such country, then the tax rate disparity test must be applied separately to the income derived by each purchasing or selling branch (by treating such purchasing or selling branch as though it alone were the remainder of the CFC) for purposes of determining whether the use of such manufacturing branch has substantially the same tax effect as if such branch were a wholly owned subsidiary corporation of the CFC.

Treas. Reg. § 1.954-3(b)(2)(i)(c) provides that with respect to manufacturing activities performed by or through a branch, purchasing or selling activities performed by or through the remainder of the CFC with respect to the personal property manufactured by or through the branch shall be treated as performed on behalf of the branch.

Treas. Reg. § 1.954-3(b)(2)(i)(d) provides that to the extent applicable, the principles of Treas. Reg. § 1.954-1(b)(4)(ii) shall be used to determine the effective rate of tax that would apply to the income of the branch. 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 (or the absence of such laws) of the countries involved.

Treas. Reg. § 301.7701-3(a) provides that a business entity that is not classified as a per se corporation under Treas. Reg. § 301.7701-2 (an "eligible entity") may elect its classification for U.S. federal income tax purposes, regardless of how it is classified by a foreign country, by making an election on Form 8832. Treas. Reg. § 301.7701-2 provides that an eligible entity with a single owner can elect to be classified as disregarded as an entity separate from its owner. Activities of the disregarded entity will be attributed to the disregarded entity's owner, and any transactions between the disregarded entity and the disregarded entity's owner (or other disregarded entities owned by the same owner) will be ignored for U.S. federal income tax purposes.

ANALYSIS

The analysis that follows applies the law set forth above to the following transaction flows:

- The Country 4 Branch purchases fabricated Product X from the Taxpayer and resells to Disregarded Entity 5 for assembly and testing. Upon completion of the assembly and testing, Disregarded Entity 5 sells finished Product X to the Country 4 Branch. The Country 4 Branch sells the finished Product X to unrelated customers and/or to Disregarded Entity 6 and Disregarded Entity 7 for direct sales to unrelated customers. These transactions are collectively referred to as the "Taxpayer Fabricated Transactions."
- The Country 4 Branch purchases fabricated Product X from Disregarded Entity 2, Disregarded Entity 3, and Disregarded Entity 4 and resells to Disregarded Entity 5 for assembly and testing. Upon completion of the assembly and testing, Disregarded Entity 5 sells finished Product X to the Country 4 Branch. The Country 4 Branch sells the finished Product X to unrelated customers and/or to Disregarded Entity 6 and Disregarded Entity 7 for direct sales to unrelated customers. These transactions are collectively referred to as the "Foreign Branch Fabricated Transactions."

1. Taxpayer Fabricated Transactions

Corporation A is a U.S. shareholder of Corporation C under the indirect ownership rule of section 958(a) because it indirectly owns 100% of Corporation C through Corporation B. Taxpayer is a U.S. shareholder of Corporation C under the indirect ownership rule of section 958(a) and the constructive ownership rule of section 958(b) because it indirectly owns 100% of Corporation C through Corporation A and Corporation B. Corporation C is a CFC because 100% of Corporation C stock is owned by U.S. shareholders. Corporation C and Taxpayer are related persons within the meaning of section 954(d)(3).

Corporation C owns an interest in Partnership 2 through Corporation D, which is disregarded for U.S. federal income tax purposes. The activities of the Country 4 Branch, Disregarded Entity 5, Disregarded Entity 6, and Disregarded Entity 7 are generally attributed to Partnership 2 for U.S. federal income tax purposes. Moreover, transactions between the Country 4 Branch, Disregarded Entity 5, Disregarded Entity 6, and Disregarded Entity 7 are generally ignored for U.S. federal income tax purposes. Thus, pursuant to the Taxpayer Fabricated Transactions, Partnership 2 derives income from purchasing personal property from Taxpayer and selling it to unrelated customers. Because Taxpayer is a related party with respect to Corporation C, such income would be FBCSI if it were received by Corporation C directly. *See* Treas. Reg. § 1.954-1(g)(1). Therefore, Corporation C's distributive share of such income qualifies as FBCSI under Treas. Reg. § 1.952-1(g)(1).

However, Corporation C's distributive share of such income will also qualify for the manufacturing exception to FBCSI if the manufacturing exception would apply to exclude the income from FBCSI if Corporation C were to earn the income directly, taking into account only the activities of, and property owned by, Partnership 2, and not the separate activities of Corporation C. *See* Treas. Reg. § 1.954-3(a)(6). The assembly and testing activities Disregarded Entity 5 performs are substantial and are generally considered to constitute manufacturing. Because Disregarded Entity is disregarded as an entity separate from Partnership 2 for U.S. federal income tax purposes, these activities are attributed to Partnership 2. As a consequence, if Corporation C were to earn the income derived from the sale of finished Product X directly, the sale would be treated as the sale of a manufactured product under Treas. Reg. § 1.954-3(a)(4)(iii), and the manufacturing exception would apply. Thus, Corporation C's distributive share of Partnership 2 income derived from the Taxpayer Fabricated Transactions qualifies for the manufacturing exception to FBCSI.

However, Disregarded Entity 5 is a branch engaged in manufacturing outside the country under the laws of which Partnership 2 is organized. Under Treas. Reg. § 1.952-1(g)(1), the determination of whether a CFC's distributive share of an item of partnership income is FBCSI requires the item to be treated as though it were received by the CFC directly. If the income were received by the CFC directly, the manufacturing branch rule would apply to determine whether any portion of that income should be treated as FBCSI. Therefore, where the partnership carries on manufacturing activities through a branch located outside the country under the laws of which the partnership is created or organized, the manufacturing branch rule of Treas. Reg. § 1.954-3(b)(1)(ii) may apply to treat the branch as a separate corporation. The determination must be made by applying the tax rate disparity test to compare the effective tax rate imposed on the income of the remainder of the partnership with the effective tax rate that would apply to such income under the laws of the country in which the branch is located, if, under the laws of such country, the entire income of the partnership were considered derived by the partnership from sources within such country from doing business

through a permanent establishment therein, received in such country, and allocable to such permanent establishment, and the partnership were created or organized under the laws of, and managed and controlled in, such country. Where tax rate disparity exists, the manufacturing branch must be treated as a separate corporation for purposes of determining FBCSI, and purchasing or selling activities performed by or through the remainder with respect to the personal property manufactured by or through the branch shall be treated as performed on behalf of the branch.

Thus, the tax rate disparity test has to be applied to determine whether Disregarded Entity 5 must be treated as a separate corporation for the purposes of determining FBCSI. Because Partnership 2 also carries on selling activities through the Country 4 Branch, Disregarded Entity 6, and Disregarded Entity 7, the tax rate disparity test must be applied separately to the income derived by each branch (by treating such branch as though it alone were the remainder). *See* Treas. Reg. § 1.954-3(b)(1)(ii)(c).

Applying Treas. Reg. § 1.954-3(b)(1)(ii)(a)-(b) and treating the Country 4 Branch as through it alone were the remainder, Disregarded Entity 5 is not treated as a separate wholly owned subsidiary corporation because the 0% rate of tax on the income of the Country 4 Branch is not less than 90% of, or at least 5 percentage points less than, the 0% rate of tax which would apply to the income of the Country 4 Branch under the laws of Country 7 if, under the laws of Country 7, all the income of Partnership 2 derived through the Country 4 Branch and Disregarded Entity 5 were derived from sources within Country 7.

Applying Treas. Reg. § 1.954-3(b)(1)(ii)(a)-(b) and treating Disregarded Entity 6 as through it alone were the remainder, Disregarded Entity 5 is not treated as a separate wholly owned subsidiary corporation because the 18% rate of tax on the income of Disregarded Entity 6 is not less than 90% of, or at least 5 percentage points less than, the 0% rate of tax which would apply to the income of Disregarded Entity 6 under the laws of Country 7 if, under the laws of Country 7, all the income of Partnership 2 derived through Disregarded Entity 5 and Disregarded Entity 6 were derived from sources within Country 7.

Applying Treas. Reg. § 1.954-3(b)(1)(ii)(a)-(b) and treating Disregarded Entity 7 as through it alone were the remainder, Disregarded Entity 5 is not treated as a separate wholly owned subsidiary corporation because the 35% rate of tax on the income of Disregarded Entity 7 is not less than 90% of, or at least 5 percentage points less than, the 0% rate of tax which would apply to the income of Disregarded Entity 7 under the laws of Country 7 if, under the laws of Country 7, all the income of Partnership 2 derived through Disregarded Entity 5 and Disregarded Entity 7 were derived from sources within Country 7.

Thus there is no tax rate disparity between Disregarded Entity 5 and the Country 4 Branch, Disregarded Entity 6, or Disregarded Entity 7. Therefore, Disregarded Entity 5 is not treated as a separate corporation for purposes of determining FBCSI. Because the manufacturing exception under Treas. Reg. § 1.954-3(a)(4) applies to Taxpayer Fabricated Transactions, and the manufacturing branch rule under section 954(d)(2) and Treas. Reg. § 1.954-3(b)(1)(ii) does not apply to such transactions, Corporation C's distributive share of Partnership 2 income derived from the Taxpayer Fabricated Transactions is not FBCSI.

2. Foreign Branch Fabricated Transactions

In the Foreign Branch Fabricated transactions, Disregarded Entity 2, Disregarded Entity 3, Disregarded Entity 4, and Disregarded Entity 5 are branches engaged in manufacturing outside the country under the laws of which Partnership 2 is organized. Therefore, the tax rate disparity test has to be applied to each to determine whether it must be treated as a separate corporation for the purposes of determining FBCSI. *See* Treas. Reg. § 1.954-3(b)(1)(ii)(a). Because Partnership 2 carries on selling activities through the Country 4 Branch, Disregarded Entity 6, and Disregarded Entity 7, the tax rate disparity test must be applied separately to the income derived by each sales branch (by treating such branch as though it alone were the remainder). *See* Treas. Reg. § 1.954-3(b)(1)(ii)(c).

As concluded in the analysis of Taxpayer Fabricated Transactions above, there is no tax rate disparity between the effective tax rate imposed by Country 7 (where Disregarded Entity 5 operates) and the effective tax rate imposed on any of the sales branches. Thus, Disregarded Entity 5 is not treated as a separate corporation for purposes of determining FBCSI.

The tax rates imposed by Country 5 (where Disregarded Entity 2 operates), Country 2 (where Disregarded Entity 3 operates), and Country 6 (where Disregarded Entity 4 operates) are 10%, 5%, and 25% respectively. Comparing these rates to the 0% tax rate imposed on the income of the Country 4 Branch, there is tax rate disparity in each case because the 0% rate is less than 90% of, and at least 5 percentage points less than, the 10%, 5% or 25% effective tax rate that would apply to the income of the Country 4 Branch if it were derived from sources within Country 5, Country 2, or Country 6 respectively. Therefore, with respect to sales of Product X by the Country 4 branch, Disregarded Entity 2, Disregarded Entity 3, and Disregarded Entity 4 will each be treated as a separate corporation for purposes of determining FBCSI. *See* Treas. Reg. § 1.954-3(b)(1)(ii)(a). The Country 4 branch will be treated as selling Product X on behalf of each of Disregarded Entity 2, Disregarded Entity 3, and Disregarded Entity 4. *See* Treas. Reg. § 1.954-3(b)(2)(i)(c).

Comparing the tax rates of Country 5, Country 2, and Country 6 to the 18% tax rate imposed on the income of Disregarded Entity 6, there is tax rate disparity only with

respect to Country 6. The 18% tax rate imposed on the income of Disregarded Entity 6 is less than 90% of, and at least 5 percentage points less than, the effective tax rate of 25% that would apply to the income of Disregarded Entity 6 if it were derived from sources within Country 6. However, the 18% tax rate is not less than 90% of, or at least 5 percentage points less than, the effective tax rate of 10% or 5% that would apply to the income of Disregarded Entity 6 if it were derived from sources within Country 5 or Country 2, respectively. Therefore, with respect to sales of Product X by Disregarded Entity 6, only Disregarded Entity 4—and not Disregarded Entity 2 or Disregarded Entity 3—will be treated as a separate corporation for purposes of determining FBCSI. *See* Treas. Reg. § 1.954-3(b)(1)(ii)(a). Disregarded Entity 6 will be treated as selling Product X on behalf of Disregarded Entity 4. *See* Treas. Reg. § 1.954-3(b)(2)(i)(c).

Comparing the tax rates of Country 5, Country 2, and Country 6 to the 35% tax rate imposed on the income of Disregarded Entity 7, there is no tax rate disparity because the 35% tax rate is not less than 90% of, or at least 5 percentage points less than, the effective tax rate of 10%, 5%, or 25% that would apply to the income of Disregarded Entity 7 if it were derived from sources within Country 5, Country 2, or Country 6 respectively. Therefore, with respect to sales of Product X by Disregarded Entity 7, Disregarded Entity 2, Disregarded Entity 3, and Disregarded Entity 4 will not be treated as separate corporations for purposes of determining FBCSI. *See* Treas. Reg. § 1.954-3(b)(1)(ii)(a).

If Disregarded Entity 2, Disregarded Entity 3, and Disregarded Entity 4 were separate corporations, each would be related to Corporation C within the meaning of section 954(d)(3). Partnership 2 thus derives income from the sale of personal property to customers on behalf of persons related to Corporation C. If Corporation C received such income directly, it would be FBCSI under section 954(d)(1). Therefore, Corporation C's distributive share of such income qualifies as FBCSI under Treas. Reg. § 1.952-1(g)(1).

However, although the Country 4 Branch and Disregarded Entity 6 must each be treated as a remainder selling on behalf of Disregarded Entity 2, Disregarded Entity 3, and Disregarded Entity 4, the remainder will in each case include the manufacturing activities of Disregarded Entity 5. Treas. Reg. § 1.954-3(b)(1)(ii)(c) requires each sales branch to be treated as though it alone were the remainder for the purpose of applying the tax rate disparity test to a manufacturing branch where one or more sales branches are used. Where tax rate disparity exists between a manufacturing branch and a sales branch, Treas. Reg. § 1.954-3(b)(2)(i)(c) provides that the remainder is treated as selling on behalf of the manufacturing branch. For purposes of Treas. Reg. § 1.954-3(b)(2)(i)(c), the remainder includes the aforementioned sales branch and any other portion of the partnership that: (1) is not a sales branch and (2) is either not a manufacturing branch or is a manufacturing branch with respect to which tax rate disparity does not exist relative to the aforementioned sales branch.

Consequently, although the Country 4 Branch comprises part of a remainder selling on behalf of Disregarded Entity 2, Disregarded Entity 3, and Disregarded Entity 4, in each case the remainder will also include Disregarded Entity 5. Similarly, although Disregarded Entity 6 comprises part of a remainder selling on behalf of Disregarded Entity 4, the remainder will also include Disregarded Entity 5. Because the assembly and testing activities Disregarded Entity 5 performs on fabricated Product X are substantial and are generally considered to constitute manufacturing, Disregarded Entity 5 will qualify each remainder for the manufacturing exception to FBCSI. Therefore, Corporation C's distributive share of Partnership 2 income derived from: (1) the sale of finished Product X by the Country 4 Branch where such Product X was fabricated by Disregarded Entity 2, Disregarded Entity 3, and Disregarded Entity 4, and (2) the sale of finished Product X by Disregarded Entity 6 where such Product X was fabricated by Disregarded Entity 4, will not be FBCSI. Thus, no portion of Corporation C's distributive share of Partnership 2 income derived from the Foreign Branch Fabricated Transactions constitutes FBCSI.

This ruling is directed only to the Taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent. Except as expressly provided herein, we express no or imply no opinion concerning the tax consequences of any aspect of any transaction or item discussed in this letter. Pursuant to a power of attorney on file in this office, a copy of this letter is being provided to your authorized representative.

Sincerely,

Ethan A. Atticks
Senior Technical Reveiwer
(International)