



LB&I International Practice Service Transaction Unit

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Shelf	N/A	Business Outbound	–	–
Volume	2	Deferral Planning	Level 1 UIL	9412
Part	2.1	Foreign Base Company Sales Issues	Level 2 UIL	9412.01
Chapter	2.1.3	Other Foreign Base Company Sales Issues	Level 3 UIL	9412.01-03
Sub-Chapter	2.1.3.1	Same Country Sales/Use Exception	–	–

Unit Name	CFC Purchase From Related Party With Same Country Sales
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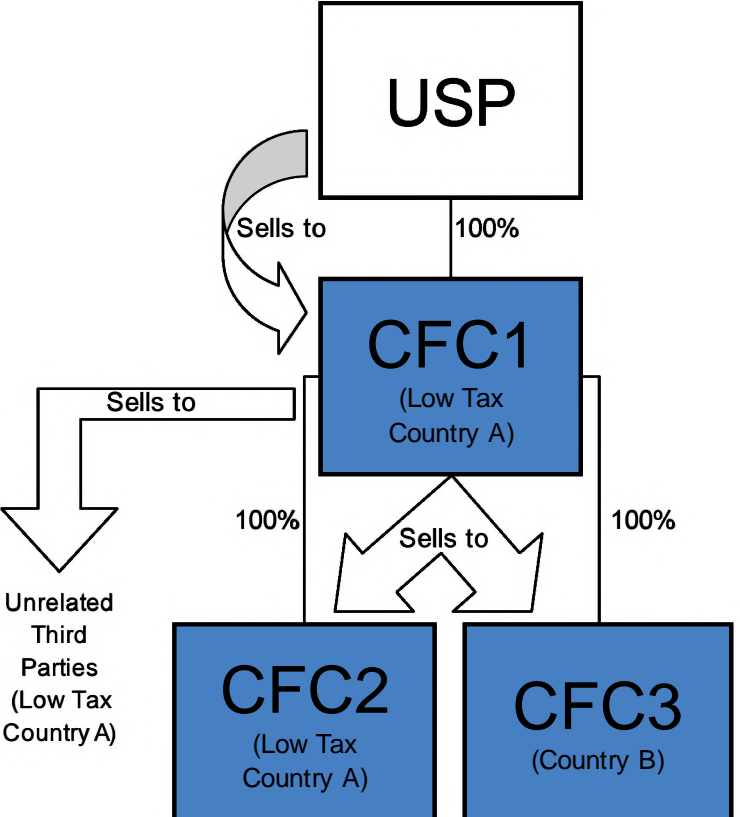
Issue and Transaction Overview

CFC Purchase From Related Party With Same Country Sales

- The US shareholders of a foreign corporation generally are not subject to US taxation on the income of the foreign corporation until an actual dividend is remitted to the US shareholders. However, the US shareholders of a controlled foreign corporation (CFC) must include in gross income their pro rata share of the CFC's subpart F income ("subpart F inclusion"). One type of subpart F income is Foreign Base Company Income, which includes Foreign Base Company Sales Income (FBCSI). FBCSI includes income from transactions involving tangible personal property where either the buyer or seller is a related party.
- One exception from FBCSI is when the property is sold for use or consumption within the CFC's country of incorporation (AKA same country sales/use exception). This Unit examines a scenario in which a CFC purchases tangible personal property from its US Parent (USP) and resells it (without any additional modification or manufacturing) to various parties. Specifically, it addresses whether the sale will qualify for the same country sales/use exception from FBCSI.
- The examiner should determine early on in the audit process the current amount of unrepatriated offshore earnings and profits (E&P), whether the CFC is engaged in transactions that generate FBCSI, and whether there are foreign tax credit offsets to any potential inclusion for FBCSI. This will allow the examiner to determine the potential tax adjustment net of any offsetting foreign tax credit.

Transaction and Fact Pattern

CFC Purchase From Related Party With Same Country Sales

Diagram of Transaction	Facts
 <p>The diagram illustrates the transaction flow. At the top is a box labeled 'USP'. A vertical line connects USP to a box labeled 'CFC1 (Low Tax Country A)'. A curved arrow labeled 'Sells to' points from USP to CFC1, and a vertical line labeled '100%' connects them. Below CFC1 are two boxes: 'CFC2 (Low Tax Country A)' on the left and 'CFC3 (Country B)' on the right. Two arrows labeled 'Sells to' point from CFC1 to CFC2 and CFC3, with vertical lines labeled '100%' connecting them. To the left of CFC1, a large arrow labeled 'Sells to' points downwards to the text 'Unrelated Third Parties (Low Tax Country A)'.</p>	<ul style="list-style-type: none">▪ USP is a multi-national company.▪ USP sells personal property to CFC1 (incorporated in Low Tax Country A).▪ CFC1 sells the personal property to CFC2 (also incorporated in Low Tax Country A), CFC3 (incorporated in Country B), and unrelated customers in Low Tax Country A.▪ CFC1 does not modify the personal property in any way or conduct any manufacturing activities.

Effective Tax Rate Overview

CFC Purchase From Related Party With Same Country Sales

ETR of Company

- The examiner should review the company's audited financial statements to determine the ETR for the years at issue and compare it to other companies in the same industry. The examiner should look for the total permanently reinvested offshore income (PRI).
- In the scenario illustrated in this Unit, the tax rate in Low Tax Country A is lower than the US rate, so profits moved to Low Tax Country A are taxed at a rate that is lower than the US rate.

ETR Impact of Adjustment

- Assuming (1) the E&P is PRI under Accounting Principles Board APB 23 (now codified as Accounting Standards Codification ASC 740-30) and (2) the income of the CFC is not subject to taxation under subpart F, the corporate group's worldwide ETR is reduced, which is important, especially for financial reporting purposes.
- An inclusion of subpart F income may increase the financial income tax expense of USP resulting in higher ETR.

Summary of Potential Issues


CFC Purchase From Related Party With Same Country Sales

<u>Issue 1</u>	Whether the sales from CFC1 (Low Tax Country A) to CFC3 (Country B) constitute FBCSI and result in a subpart F inclusion to USP.
<u>Issue 2</u>	Whether the sales from CFC1 (Low Tax Country A) to CFC2 (Low Tax Country A) constitute FBCSI and result in a subpart F inclusion to USP.
<u>Issue 3</u>	Whether the sales from CFC1 (Low Tax Country A) to unrelated third parties in Low Tax Country A constitute FBCSI and result in a subpart F inclusion to USP.

All Issues, Step 1: Initial Factual Development

CFC Purchase From Related Party With Same Country Sales


Taxpayer may be selling through a CFC to shift sales profit out of the US (or from a CFC in a relatively high tax jurisdiction) into a country with a lower tax rate. A subpart F functional analysis is necessary to identify what activities each entity performs with regard to buying and/or selling personal property. Take note that IRC 482 may also apply to purchases and/or sales between related parties because application of IRC 482 and IRC 954 is not mutually exclusive.

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ USP sells personal property to a CFC, which in turn re-sells the property to related CFCs and unrelated third parties. The related party transactions should be identified on Sch. M of the Form 5471 and should be discussed in the transfer pricing study. In addition, it is possible that the taxpayer may have performed a subpart F or supply chain functional analysis. 	<ul style="list-style-type: none"> ▪ Form 5471 ▪ Form 5471 Instructions ▪ Mandatory Transfer Pricing Information Document Request (IDR) ▪ Global Tax and Legal Organizational Charts ▪ Steps of Transactions ▪ Contracts containing the critical facts of the transactions ▪ Product Flows and Transaction Flowcharts 	
 <p>CONSULTATION: The examiner should consult with the Transfer Pricing Practice or Income Shifting IPN regarding any potential transfer pricing issues.</p>		

All Issues, Step 1: Initial Factual Development (cont'd)

CFC Purchase From Related Party With Same Country Sales

Taxpayer may be selling through a CFC to shift sales profit out of the US (or from a CFC in a relatively high tax jurisdiction) into a country with a lower tax rate. A subpart F functional analysis is necessary to identify what activities each entity performs with regard to buying and/or selling personal property. Take note that IRC 482 may also apply to purchases and/or sales between related parties because application of IRC 482 and IRC 954 is not mutually exclusive.

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ Note: the personal property in this unit's example is assumed to be used, consumed, and/or disposed of in the same location to which it is delivered/sold; this concept is known as the "destination test". Revenue agents should verify whether the destination test (Treas. Reg. 1.954-3(a)(3)(ii)) is met. 	<ul style="list-style-type: none"> ▪ Form 5471 ▪ Form 5471 Instructions ▪ Mandatory Transfer Pricing IDR ▪ Global Tax and Legal Organizational Charts ▪ Steps of Transactions ▪ Contracts containing the critical facts of the transactions ▪ Product Flows and Transaction Flowcharts 	
 <p>DECISION POINT: The examiner should consider the current amount of unrepatriated offshore E&P, as a FBCSI inclusion is limited to this amount.</p>	<ul style="list-style-type: none"> ▪ IRC 952(c)(1)(A) 	

Issue 1, Step 2: Review Potential Issues

CFC Purchase From Related Party With Same Country Sales

Issue 1

Whether the sales from CFC1 (Low Tax Country A) to CFC3 (Country B) constitute FBCSI and result in a subpart F inclusion to USP.

Explanation of Issue	Resources
<ul style="list-style-type: none">▪ When a CFC buys/sells tangible personal property (1) from/to a <i>related person</i> and the property is (2) manufactured, produced, grown, or extracted <i>outside</i> the CFC's country of incorporation and the property is purchased/sold (3) for use, consumption or disposition <i>outside</i> the CFC's country of incorporation, the income from the sale of the property by the CFC is FBCSI, a type of subpart F income, and the US shareholder(s) of the CFC may be required to include in gross income their pro rata share of the CFC's subpart F income under IRC 951.▪ When a CFC buys or sells tangible personal property, you should determine whether the transaction has the following three requirements for FBCSI:<ol style="list-style-type: none">1. Related person requirement.2. Place of manufacture requirement.3. Place of consumption or use requirement.	<ul style="list-style-type: none">▪ IRC 951▪ IRC 954(d)▪ IRC 954(d)(3)▪ Treas. Reg. 1.954-3

Issue 1, Step 3: Additional Factual Development

CFC Purchase From Related Party With Same Country Sales

Issue 1

Whether the sales from CFC1 (Low Tax Country A) to CFC3 (Country B) constitute FBCSI and result in a subpart F inclusion to USP.

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ Related person requirement: No FBCSI unless the CFC buys from or sells to a “related party” (someone that controls the CFC, is controlled by the CFC, or is controlled by those that control the CFC). 	<ul style="list-style-type: none"> ▪ IRC 954(d)(3) ▪ The examiner should have reviewed organizational charts and transaction agreements during initial factual development to establish whether a related party transaction took place. ▪ No additional factual development should be needed. 	

Issue 1, Step 3: Additional Factual Development (cont'd)

CFC Purchase From Related Party With Same Country Sales

Issue 1

Whether the sales from CFC1 (Low Tax Country A) to CFC3 (Country B) constitute FBCSI and result in a subpart F inclusion to USP.

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ Place of consumption or use requirement: No FBCSI if the property is sold for use or consumption within the CFC's country of incorporation. 	<ul style="list-style-type: none"> ▪ IRC 954(d)(1)(B) ▪ Many US companies request a tax package, organizer, or other similar information from the CFC in order to prepare the 5471s. Request a copy and review for further details of the facts. ▪ In addition, consider requesting schedules of sales by destination and copies of local country Value Added Tax (VAT) returns to verify place of sale, use or consumption. 	

Issue 1, Step 3: Additional Factual Development (cont'd)

CFC Purchase From Related Party With Same Country Sales

Issue 1

Whether the sales from CFC1 (Low Tax Country A) to CFC3 (Country B) constitute FBCSI and result in a subpart F inclusion to USP.

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ Place of manufacture requirement: No FBCSI if the property is manufactured by anyone within the CFC's country of incorporation. 	<ul style="list-style-type: none"> ▪ IRC 954(d)(1)(A) ▪ VAT returns will be useful in determining where purchased property is acquired from (i.e. if the property is acquired from outside the country, then most likely, it was manufactured outside the country) or sold to. ▪ In addition, review the functional analysis and/or conduct taxpayer interviews. 	

Issue 1, Step 4: Develop Arguments

CFC Purchase From Related Party With Same Country Sales

Issue 1

Whether the sales from CFC1 (Low Tax Country A) to CFC3 (Country B) constitute FBCSI and result in a subpart F inclusion to USP.


Explanation of Adjustment	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ The factual development should have included a review of Schedule M of Form 5471 (and supporting documentation), subpart F and/or supply chain functional analysis, and the transfer pricing study. ▪ The factual development in this case indicates CFC1 purchases from a related party, USP, and sells to a related party, CFC3, and the property is sold and manufactured outside Country A. CFC1's sales income is FBCSI, and USP has an inclusion under IRC 951. 	<ul style="list-style-type: none"> ▪ IRC 954(d) ▪ Treas. Reg. 1.954-1(f)(1) & (2) ▪ Treas. Reg.1.954-3(a)(3)(i) ▪ Treas. Reg.1.954-3(a)(2) ▪ Bittker & Lokken Fundamentals of International Taxation 69.5 ▪ Form 5471 ▪ Form 5471 Instructions 	

Issue 1, Step 4: Develop Arguments (cont'd)

CFC Purchase From Related Party With Same Country Sales

Issue 1

Whether the sales from CFC1 (Low Tax Country A) to CFC3 (Country B) constitute FBCSI and result in a subpart F inclusion to USP.

Explanation of Adjustment	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ Calculate the amount of the subpart F inclusion (see UIL 9412.05 General Subpart F Computational Issues), and be sure to consider Foreign Tax Credit (FTC) implications (e.g. some indirect foreign tax credit offset – see UIL 9413). <p> DECISION POINT: The examiner should consider the current amount of unrepatriated offshore E&P, as a FBCSI inclusion is limited to this amount.</p> <ul style="list-style-type: none"> ▪ Note that transfer pricing policies may impact the amount of subpart F inclusions, hence the need to review the transfer pricing study in conjunction with subpart F analysis. 	<ul style="list-style-type: none"> ▪ IRC 952(c)(1)(A) 	

Issue 2, Step 2: Review Potential Issues

CFC Purchase From Related Party With Same Country Sales

Issue 2

Whether the sales from CFC1 (Low Tax Country A) to CFC2 (Low Tax Country A) constitute FBCSI and result in a subpart F inclusion to USP.

Explanation of Issue	Resources
<ul style="list-style-type: none">▪ When a CFC buys/sells tangible personal property from/to a <i>related person</i> and the property is manufactured, produced, grown, or extracted <i>outside</i> the CFC's country of incorporation and the property is purchased/sold for use, consumption or disposition <i>within</i> the country of incorporation, the income is <i>not</i> FBCSI under IRC 954, and the US shareholder(s) will not have a corresponding gross income inclusion under IRC 951. This is commonly referred to as the "same country of sales/use exception" for FBCSI.	<ul style="list-style-type: none">▪ IRC 951▪ IRC 954(d)▪ IRC 954(d)(3)▪ Treas. Reg. 1.954-3

Issue 2, Step 3: Additional Factual Development

CFC Purchase From Related Party With Same Country Sales

Issue 2

Whether the sales from CFC1 (Low Tax Country A) to CFC2 (Low Tax Country A) constitute FBCSI and result in a subpart F inclusion to USP.

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ Related person requirement: No FBCSI unless the CFC buys from or sells to a “related party” (someone that controls the CFC, is controlled by the CFC, or is controlled by those that control the CFC). 	<ul style="list-style-type: none"> ▪ IRC 954(d)(3) ▪ The examiner should have reviewed organizational charts and transaction agreements during initial factual development to establish whether a related party transaction took place. ▪ No additional factual development should be needed. 	

Issue 2, Step 3: Additional Factual Development (cont'd)

CFC Purchase From Related Party With Same Country Sales

Issue 2

Whether the sales from CFC1 (Low Tax Country A) to CFC2 (Low Tax Country A) constitute FBCSI and result in a subpart F inclusion to USP.

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ Place of consumption or use requirement: No FBCSI if the property is sold for use or consumption within the CFC's country of incorporation. 	<ul style="list-style-type: none"> ▪ IRC 954(d)(1)(B) ▪ Many US companies request a tax package, organizer, or other similar information from the CFC in order to prepare the 5471s. Request a copy and review for further details of the facts. ▪ In addition, consider requesting schedules of sales by destination and copies of local country VAT returns to verify place of sale, use or consumption. 	

Issue 2, Step 3: Additional Factual Development (cont'd)

CFC Purchase From Related Party With Same Country Sales

Issue 2

Whether the sales from CFC1 (Low Tax Country A) to CFC2 (Low Tax Country A) constitute FBCSI and result in a subpart F inclusion to USP.

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ Place of manufacture requirement: No FBCSI if the property is manufactured by anyone within the CFC's country of incorporation. 	<ul style="list-style-type: none"> ▪ IRC 954(d)(1)(A) ▪ VAT returns will be useful in determining where purchased property is acquired from (i.e. if the property is acquired from outside the country, then most likely, it was manufactured outside the country) or sold to. ▪ In addition, review the functional analysis and/or conduct taxpayer interviews. 	

Issue 2, Step 4: Develop Arguments

CFC Purchase From Related Party With Same Country Sales

Issue 2

Whether the sales from CFC1 (Low Tax Country A) to CFC2 (Low Tax Country A) constitute FBCSI and result in a subpart F inclusion to USP.

Explanation of Adjustment	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ The factual development should have included a review of Schedule M of Form 5471 (and supporting documentation), subpart F and/or supply chain functional analysis, and the transfer pricing study. ▪ The factual development in this case indicates CFC1 purchases from a related party, USP, and sells to a related party, CFC2, in Country A. CFC1's sales income meets the "same country sales/use exception" and is <i>not</i> FBCSI. 	<ul style="list-style-type: none"> ▪ IRC 954(d) ▪ Treas. Reg.1.954-1(f)(1) ▪ Treas. Reg.1.954-3(a)(3)(i) ▪ Treas. Reg.1.954-3(a)(2) 	

Issue 3, Step 2: Review Potential Issues

CFC Purchase From Related Party With Same Country Sales

Issue 3

Whether the sales from CFC1 (Low Tax Country A) to unrelated third parties in Low Tax Country A constitute FBCSI and result in a subpart F inclusion to USP.

Explanation of Issue	Resources
<ul style="list-style-type: none">When a CFC buys/sells tangible personal property from/to a <i>related person</i> and the property is manufactured, produced, grown, or extracted <i>outside</i> the CFC's country of incorporation and the property is purchased/sold for use, consumption or disposition <i>within</i> the country of incorporation, the US shareholder(s) of the CFC is <i>not</i> required to recognize an inclusion under IRC 951 because the CFC does not have FBCSI under 954(d). This is commonly referred to as the "same country of sales/use exception" from FBCSI.	<ul style="list-style-type: none">IRC 951IRC 954(d)IRC 954(d)(3)Treas. Reg. 1.954-3

Issue 3, Step 3: Additional Factual Development

CFC Purchase From Related Party With Same Country Sales

Issue 3

Whether the sales from CFC1 (Low Tax Country A) to unrelated third parties in Low Tax Country A constitute FBCSI and result in a subpart F inclusion to USP.

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ Related person requirement: No FBCSI unless the CFC buys from or sells to a “related party” (someone that controls the CFC, is controlled by the CFC, or is controlled by those that control the CFC). 	<ul style="list-style-type: none"> ▪ IRC 954(d)(3) ▪ The examiner should have reviewed organizational charts and transaction agreements during initial factual development to establish whether a related party transaction took place. ▪ No additional factual development should be needed. 	

Issue 3, Step 3: Additional Factual Development (cont'd)

CFC Purchase From Related Party With Same Country Sales

Issue 3

Whether the sales from CFC1 (Low Tax Country A) to unrelated third parties in Low Tax Country A constitute FBCSI and result in a subpart F inclusion to USP.

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ Place of consumption or use requirement: No FBCSI if the property is sold for use or consumption within the CFC's country of incorporation. 	<ul style="list-style-type: none"> ▪ IRC 954(d)(1)(B) ▪ Many US companies request a tax package, organizer, or other similar information from the CFC in order to prepare the 5471s. Request a copy and review for further details of the facts. ▪ In addition, consider requesting schedules of sales by destination and copies of local country VAT returns to verify place of sale, use or consumption. 	

Issue 3, Step 3: Additional Factual Development (cont'd)

CFC Purchase From Related Party With Same Country Sales

Issue 3

Whether the sales from CFC1 (Low Tax Country A) to unrelated third parties in Low Tax Country A constitute FBCSI and result in a subpart F inclusion to USP.

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ Place of manufacture requirement: No FBCSI if the property is manufactured by anyone within the CFC's country of incorporation. 	<ul style="list-style-type: none"> ▪ IRC 954(d)(1)(A) ▪ VAT returns will be useful in determining where purchased property is acquired from (i.e. if the property is acquired from outside the country, then most likely, it was manufactured outside the country) or sold to. ▪ In addition, review the functional analysis and/or conduct taxpayer interviews. 	

Issue 3, Step 4: Develop Arguments

CFC Purchase From Related Party With Same Country Sales

Issue 3

Whether the sales from CFC1 (Low Tax Country A) to unrelated third parties in Low Tax Country A constitute FBCSI and result in a subpart F inclusion to USP.

Explanation of Adjustment	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ The factual development should have included a review of Schedule M of Form 5471 (and supporting documentation), subpart F and/or supply chain functional analysis, and the transfer pricing study. ▪ The factual development in this case indicates CFC1 purchases from a related party, USP, and sells to a unrelated parties in Country A. CFC1's sales income meets the "same country sales/use exception" and is <i>not</i> FBCSI. 	<ul style="list-style-type: none"> ▪ IRC 954(d) ▪ Treas. Reg.1.954-1(f)(1) ▪ Treas. Reg.1.954-3(a)(3)(i) ▪ Treas. Reg.1.954-3(a)(2) ▪ Lead Sheets (SAIN 706 Leadsheet) 	

Training and Additional Resources

Chapter 2.1.3 Other Foreign Base Company Sales Issues

Type of Resource	Description(s) and/or Instructions for Accessing	References
CENTRA sessions	<ul style="list-style-type: none"> FY10 IBC CPE Subpart F and IBC CPE FBCSI Substantial Contribution August 2013 	<ul style="list-style-type: none"> International Current Topics in Subpart F Centra FBCSI Substantial Contribution Aug 2013
White Papers / Guidance	<ul style="list-style-type: none"> IRM 4.61.7 IRM 4.61.3.5.1 	<ul style="list-style-type: none"> IRM 4.61.7 Controlled Foreign Corporations IRM 4.61.3.5.1 Functional Analysis
Podcasts / Videos	<ul style="list-style-type: none"> FY2011 CPE 	<ul style="list-style-type: none"> Training - FY2011 CPE Live Recordings Training Deferral Planning CPE July 2011

Training and Additional Resources (cont'd)

Chapter 2.1.3 Other Foreign Base Company Sales Issues		
Type of Resource	Description(s) and/or Instructions for Accessing	References
Other Training Materials	<ul style="list-style-type: none"> IE Phase Training materials 	<ul style="list-style-type: none"> On-the-Job Training for International Examiners (IE) - Subpart F Phase I IE Training Subpart F Module Phase III IE Training Subpart F Module
Reference Material – Treatises		<ul style="list-style-type: none"> Kuntz & Peroni US International Taxation B3.05 Bittker & Lokken Fundamentals of International Taxation 69.5

Glossary of Terms and Acronyms

Term/Acronym	Definition
CFC	Controlled Foreign Corporation
E&P	Earnings and Profits
ETR	Effective Tax Rate
FBCSI	Foreign Base Company Sales Income
FTC	Foreign Tax Credit
PRI	Permanently Reinvested (Offshore) Income
USP	United States Parent
VAT	Value Added Tax

Index of Related Issues

Issue	Associated UIL(s)	References
Sales or leases of tangible property/goods	▪ 9411.05	
General Subpart F Computational Issues	▪ 9412.05	
FTC Management	▪ 9413	