



## LB&I International Practice Service Concept Unit

IPS Level	Number	Title	UIL Code	Number
Shelf	N/A	Business Outbound	–	–
Volume	2	Deferral Planning	Level 1 UIL	9412
Part	2.1	Foreign Base Company Sales Income	Level 2 UIL	9412.01
Chapter	N/A	N/A	Level 3 UIL	N/A
Sub-Chapter	N/A	N/A	–	–

<b>Unit Name</b>	Concepts of Foreign Base Company Sales Income
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<b>Document Control Number (DCN)</b>	DPL/CU/P_2.1_11(2015)
<b>Date of Last Update</b>	08/25/15

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# Table of Contents

*(View this PowerPoint in “Presentation View” to click on the links below)*

[General Overview](#)

[Relevant Key Factors](#)

[Detailed Explanation of the Concept](#)

[Examples of the Concept](#)

[Training and Additional Resources](#)

[Glossary of Acronyms](#)

[Index of Related Issues](#)

# General Overview

## Concepts of Foreign Base Company Sales Income (FBCSI)

A U.S. shareholder of a foreign corporation generally is not subject to tax on the income of the corporation until the shareholder receives a distribution from the corporation. However, under subpart F, certain types of income earned by a controlled foreign corporation (CFC) are currently included in the income of the CFC's U.S. shareholders even if the CFC does not distribute the income to its shareholders in that year. One such type of income is Foreign Base Company Sales Income (FBCSI), which is income derived by a CFC from a purchase or sale\* of personal property involving a related party in which the goods are both manufactured and sold for use/consumption outside the CFC's country of organization.

In general, if the property is manufactured or sold for use or consumption inside the CFC's country of organization, the likelihood is that choice of CFC location was motivated by business, rather than tax, considerations. In other words, a taxpayer is likely to achieve a lower rate of tax on sales income only through purchases or sales outside the CFC's country of organization. Accordingly, FBCSI does not include income from the purchase or sale of goods manufactured in the CFC's country (referred to as the "same country manufacturing exception", see Treas. Reg. 1.954-3(a)(3)) or of goods sold for use/consumption in the CFC's country (the "same country sales/use exception", see Treas. Reg. 1.954-3(a)(2)).

In addition, Congress only intended to include in FBCSI "income from the purchase and sale of property, without any appreciable value being added to the product by the selling corporation" (S. Rep. No. 1881, 87th Cong., 2d Sess., reprinted at 1962-3 CB 703, 790). Accordingly, Treas. Reg. 1.954-3(a)(4) provides that FBCSI does not include income from the purchase or sale of property manufactured by the CFC itself (the "CFC manufacturing exception", covered briefly on the next slide).



**CONSULTATION:** Note that purchases and/or sales between related parties may implicate not only IRC 954 but also IRC 482 because FBCSI adjustments and transfer pricing adjustments are not mutually exclusive. The examiner should consult with the Transfer Pricing Practice or Income Shifting IPN regarding any potential transfer pricing issues.

\*Note that FBCSI includes income from selling *or purchasing*, but often only sales/selling is mentioned for ease of reference.

# General Overview (cont'd)

## Concepts of Foreign Base Company Sales Income (FBCSI)

Many taxpayers utilize the check the box rules in their supply chain structures to treat a foreign entity as disregarded for U.S. tax purposes. In such cases, the examiner should consider whether FBCSI branch rules (which are beyond the scope of this unit) may apply to treat the branch/disregarded entity (DE) and the remainder of the CFC as separate entities for purposes of determining whether the CFC has FBCSI. Refer to IPS units on the branch rules for additional information (*Branch Rules for Foreign Base Company Sales Income* DPL/CU/C\_2.1.2\_07(2015); *Branch Sales to Unrelated Parties of Products Manufactured by CFC* DPL/9412.01\_08(2015); *Sale by CFC to Unrelated Parties of Products Manufactured by Branch* DPL/9412.01\_06(2015)).

### Exceptions:

As noted on the previous slide, FBCSI does *not* include income of a CFC from the sale of personal property manufactured, produced or constructed by such corporation. Treas. Reg. 1.954-3(a)(4). The CFC manufacturing exception may be satisfied through one of three tests:

- Substantial transformation - Treas. Reg. 1.954-3(a)(4)(ii)
- Component parts - Treas. Reg. 1.954-3(a)(4)(iii)
- Substantial contribution - Treas. Reg. 1.954-3(a)(4)(iv)

These tests, and the CFC manufacturing exception itself, are covered in separate IPS units.

# Relevant Key Factors

## Concepts of Foreign Base Company Sales Income (FBCSI)

### Key Factors

FBCSI means income (whether in the form of profits, commissions, fees, or otherwise) derived in connection with the sale/purchase of personal property to, from, or on behalf of, a related person where the property is manufactured, produced, grown, or extracted outside the CFC's country and sold for use or consumption outside the CFC's country. IRC 954(d).

In determining whether to apply the FBCSI rules, three key factors must generally be addressed with respect to the CFC.

1. Whether the CFC derived income in connection with sales/purchases of personal property to, from, or on behalf of, a related person.
2. Whether the personal property sold by the CFC was manufactured, produced, grown, or extracted outside the CFC's country of organization.
3. Whether the personal property was sold/purchased for use or consumption outside of the CFC's country of organization.

These factors can be determined by performing a functional analysis and reviewing relevant contracts.



# Detailed Explanation of the Concept (cont'd)

## Concepts of Foreign Base Company Sales Income (FBCSI)

1. Whether the CFC derived income in connection with sales/purchases of personal property to, from, or on behalf of, a related person.

Analysis	Resources
Note that even if a CFC doesn't hold title to the personal property in question, the CFC will still have FBCSI if it derives income in connection with the sale or purchase of that property since FBCSI consists of gross income from profits, commissions, fees, etc. derived in connection with the sale or purchase of personal property.	▪ Treas. Reg. 1.954-3(a)(1)

# Detailed Explanation of the Concept (cont'd)

## Concepts of Foreign Base Company Sales Income (FBCSI)

2. Whether the personal property sold by the CFC was manufactured, produced, grown, or extracted outside the CFC's country of organization.

Analysis	Resources
<p>FBCSI does not include income derived in connection with the purchase or sale of personal property if the property is manufactured, produced, constructed, grown, or extracted in the CFC's country of organization. For example, CFC B (a subsidiary of CFC C, with both CFCs organized in foreign country X) purchases and imports into country X rough diamonds mined in foreign country Y. In country X, CFC B cuts, polishes, and shapes the diamonds in a process which constitutes manufacturing. CFC B sells the finished diamonds to CFC C (a related person), who in turn sells them for use in foreign country Z. Since the finished diamonds are manufactured in country X, gross income derived by CFC C from their sale is not foreign base company sales income. Treas. Reg. 1.954-3(a)(2) Example 2.</p> <p>Note: the definition of manufacturing (e.g. substantial transformation, component parts, substantial contribution) and the concept of functional analysis are beyond the scope of this unit and are covered in separate IPS Practice Units.</p>	<ul style="list-style-type: none"><li>▪ IRC 954(d)(1) (A)</li><li>▪ Treas. Reg. 1.954-3(a)(2)</li></ul>

# Detailed Explanation of the Concept (cont'd)

## Concepts of Foreign Base Company Sales Income (FBCSI)

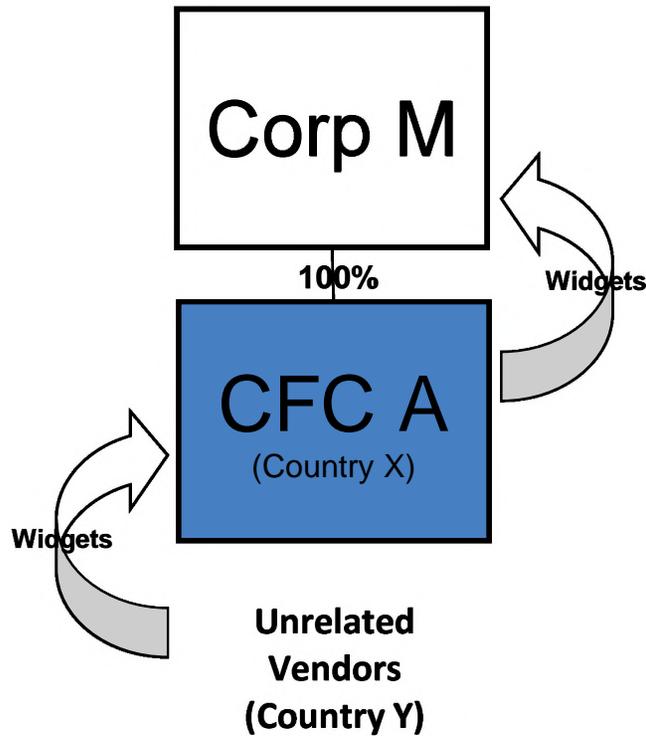
3. Whether the personal property was sold/purchased for use or consumption outside of the CFC's country of organization

Analysis	Resources
<p>FBCSI does not include income derived in connection with the purchase or sale of personal property if the property is sold for use, consumption, or disposition* in the CFC's country of organization. Under the "destination test", personal property sold to an unrelated person is presumed to be used in the location to which it is delivered/sold. However, if at the time of sale the CFC knew or should have known from the facts and circumstances surrounding the sale that the property probably would not be used in the country of destination, then the CFC must determine the country of ultimate use, or the property will be presumed to have been used outside the CFC's country of organization. A CFC that sells personal property to a related person is presumed to sell the property for use outside the CFC's country of organization unless the CFC establishes the use made of the property by the related person.</p> <p>While FBCSI does not include income from sales/purchases made to parties within the CFC's country of organization, in some cases, the personal property in question is destined for use both within and outside the CFC's country of organization. If the CFC knows, or should have known from the facts and circumstances that this is the case, and the countries of ultimate use cannot reasonably be specifically traced, apportionment will generally be necessary to determine the income that is FBCSI versus the income that is not FBCSI.</p> <p>*For ease of reference, this unit refers simply to "use" to indicate use, consumption, or disposition.</p>	<ul style="list-style-type: none"> <li>▪ IRC 954(d)(1)(B)</li> <li>▪ Treas. Reg. 1.954-3(a)(3)</li> <li>▪ Treas. Reg. 1.954-3(a)(3)(ii)</li>   <li>▪ Treas. Reg. 1.954-3(a)(3)(iii)</li> </ul>

# Examples of the Concept

## Concepts of Foreign Base Company Sales Income (FBCSI)

### Example 1



CFC A, incorporated under the laws of foreign country X, is a wholly owned subsidiary of domestic corporation M.

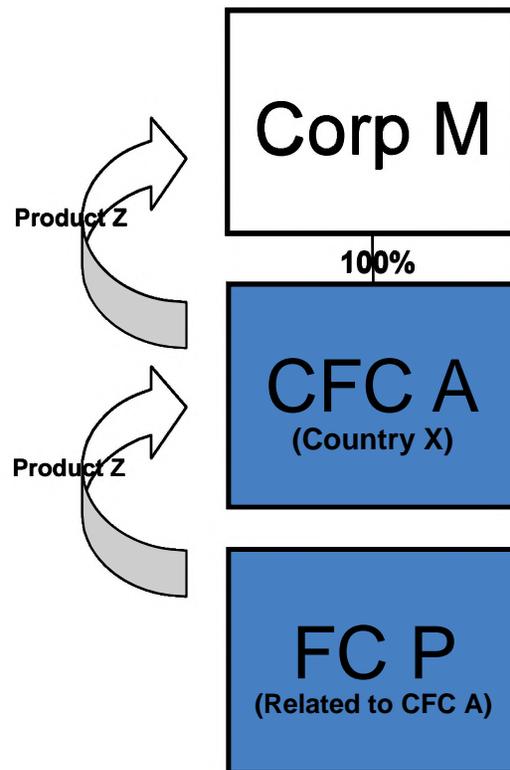
CFC A purchases widgets produced by unrelated vendors in country Y and sells the widgets to Corp M, a related person, for use in the United States.

Income from the sale of the widgets by CFC A is FBCSI since the widgets were manufactured outside country X and sold to a related party for use outside country X.

# Examples of the Concept (cont'd)

## Concepts of Foreign Base Company Sales Income (FBCSI)

### Example 2



CFC A, incorporated under the laws of foreign country X, is a wholly owned subsidiary of domestic corporation M.

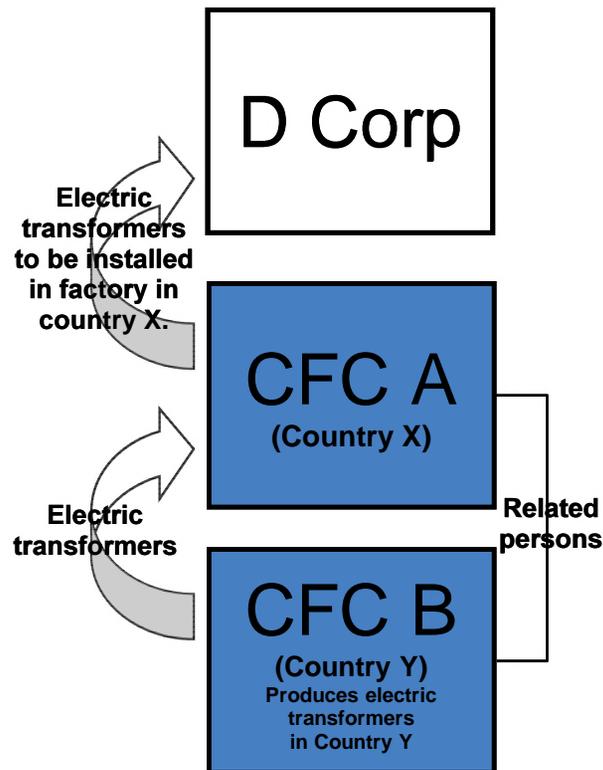
CFC A purchases Product Z manufactured in country X from foreign corporation P, a related person, and sells Product Z to Corp M, a related person, for use in the United States.

Income from the purchase and sale of Product Z by CFC A is not FBCSI since Product Z was manufactured in country X.

# Examples of the Concept (cont'd)

## Concepts of Foreign Base Company Sales Income (FBCSI)

### Example 3



CFC A, incorporated under the laws of foreign country X, and CFC B, incorporated under the laws of foreign country Y, are related persons. CFC A purchases from CFC B electric transformers produced by CFC B in country Y and sells the transformers to D Corporation, an unrelated person, for installation in a factory building being constructed in country X.

Since the personal property purchased and sold by CFC A is to be used within CFC A's country, income of CFC A derived from the purchase and sale of the electric transformers is not FBCSI.

Treas. Reg. 1.954-3(a)(3) Example 1.

# Training and Additional Resources

## Concepts of Foreign Base Company Sales Income (FBCSI)

Type of Resource	Description(s) and/or Instructions for Accessing	References
CENTRA sessions	<ul style="list-style-type: none"> <li>▪ Training - FY 2011 CPE "Live" Recordings</li> <li>▪ CLE Centra – Subpart F 20130930</li> <li>▪ 2010 Centra – Subpart F update</li> <li>▪ Subpart F and the Substantial Contribution Rules August 2013 (VNN789444)</li> </ul>	<ul style="list-style-type: none"> <li>▪ Discussion of FBCSI is included in the resources at left.</li> </ul>
White Papers / Guidance	<ul style="list-style-type: none"> <li>▪ Westlaw subscription</li> </ul>	<ul style="list-style-type: none"> <li>▪ Bittker &amp; Lokken 69.5</li> <li>▪ FAA20153301F</li> </ul>
Bloomberg BNA		<ul style="list-style-type: none"> <li>▪ TMFEDPORT No. 928-3rd VII. Foreign Base Company Sales Income</li> </ul>

# Glossary of Terms and Acronyms

Term/Acronym	Definition
CFC	Controlled Foreign Corporation
FAA	Field Attorney Advice
FBCSI	Foreign Base Company Sales Income
FBCSvcl	Foreign Base Company Services Income

# Index of Related Issues

Issue	Associated UIL(s)	References
Sales or leases of tangible property/goods	<ul style="list-style-type: none"> <li>▪ 9411.05, 9422.07</li> </ul>	<ul style="list-style-type: none"> <li>▪ Various units available</li> </ul>
Subpart F Overview	<ul style="list-style-type: none"> <li>▪ 9412, 9433.01</li> </ul>	<ul style="list-style-type: none"> <li>▪ Subpart F Overview, DPL/CU/V_2_01(2013); Overview of Subpart F Income for U.S. Individual Shareholders, FEN/9433.01_09(2013)</li> </ul>
Same country sales/use exception from FBCSI	<ul style="list-style-type: none"> <li>▪ 9412.01</li> </ul>	<ul style="list-style-type: none"> <li>▪ CFC Purchase From Related Party With Same Country Sales, DPL/9412.01_01(2015)</li> </ul>
Same country manufacturing exception from FBCSI	<ul style="list-style-type: none"> <li>▪ 9412.01</li> </ul>	<ul style="list-style-type: none"> <li>▪ CFC Sale to Related Party With Same Country Unrelated Party Manufacturing, DPL/9412.01_03(2015)</li> </ul>
Branch Rules	<ul style="list-style-type: none"> <li>▪ 9412.01-02</li> </ul>	<ul style="list-style-type: none"> <li>▪ Branch Rules for Foreign Base Company Sales Income, DPL/CU/C_2.1.2_07(2015)</li> </ul>
Manufacturing branch	<ul style="list-style-type: none"> <li>▪ 9412.01-02</li> </ul>	<ul style="list-style-type: none"> <li>▪ Sale by CFC to Unrelated Parties of Products Manufactured by Branch, DPL/9412.01_06(2015)</li> </ul>
Sales branch	<ul style="list-style-type: none"> <li>▪ 9412.01-02</li> </ul>	<ul style="list-style-type: none"> <li>▪ Branch Sales to Unrelated Parties of Products Manufactured by CFC, DPL/9412.01_08(2015)</li> </ul>
Foreign Base Company Income	<ul style="list-style-type: none"> <li>▪ 9412.05</li> </ul>	<ul style="list-style-type: none"> <li>▪ Computing Foreign Base Company Income, DPL/9412.05_05(2013)</li> </ul>
Functional Analysis	<ul style="list-style-type: none"> <li>▪ 9412.06</li> </ul>	<ul style="list-style-type: none"> <li>▪ Conducting Functional Analysis for Foreign Base Company Income (FBCI), DPL/9412.06_12(2015)</li> </ul>