

HIGHLIGHTS OF THIS ISSUE

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

INCOME TAX

Rev. Rul. 2012-6, page 349.

Insurance companies; interest rate tables. Prevailing state assumed interest rates are provided for the determination of reserves under section 807 of the Code for contracts issued in 2011 and 2012. Rev. Rul. 92-19 supplemented in part.

Rev. Rul. 2012-7, page 362.

Federal rates; adjusted federal rates; adjusted federal long-term rate and the long-term exempt rate. For purposes of sections 382, 642, 1274, 1288, and other sections of the Code, tables set forth the rates for February 2012.

T.D. 9563, page 354.

Final regulations under section 954 of the Code provide guidance relating to foreign base company sales income in cases in which personal property sold by a controlled foreign corporation is purchased, sold, manufactured, produced, grown or extracted by one or more branches of the controlled foreign corporations.

Announcement 2012-6, page 366.

This document contains changes to Publication 1220, *Specifications for Filing Forms 1097, 1098, 1099, 3921, 3922, 5498, and W-2G Electronically* (Rev. 9-2011), Publication 1187, *Specification for Filing Form 1042-S, Foreign Person's U.S. Source Income Subject to Withholding, Electronically* (Rev. 10-2011), and Publication 1239, *Specifications for Filing Form 8027, Employer's Annual Information Return of Tip Income and Allocated Tips, Electronically* (Rev. 10-2011). Rev. Procs. 2011-40, 2011-50, and 2011-51 corrected.

EMPLOYEE PLANS

Announcement 2012-7, page 367.

This document contains a correction to Rev. Proc. 2012-8, 2012-1 I.R.B. 235, which contains a typographical error in section 6.07(5). This announcement corrects that error. Rev. Proc. 2012-8 corrected.

ADMINISTRATIVE

Notice 2012-12, page 365.

Restitution payments to victims of human trafficking. This notice advises taxpayers that mandatory restitution payments awarded to victims of human trafficking under 18 U.S.C. section 1593 are excluded from gross income under section 61 of the Code for federal income tax purposes.

Announcement 2012-6, page 366.

This document contains changes to Publication 1220, *Specifications for Filing Forms 1097, 1098, 1099, 3921, 3922, 5498, and W-2G Electronically* (Rev. 9-2011), Publication 1187, *Specification for Filing Form 1042-S, Foreign Person's U.S. Source Income Subject to Withholding, Electronically* (Rev. 10-2011), and Publication 1239, *Specifications for Filing Form 8027, Employer's Annual Information Return of Tip Income and Allocated Tips, Electronically* (Rev. 10-2011). Rev. Procs. 2011-40, 2011-50, and 2011-51 corrected.

Finding Lists begin on page ii.



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Provide America's taxpayers top-quality service by helping them understand and meet their tax responsibilities and en-

force the law with integrity and fairness to all.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents are compiled semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations,

court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1986 Code.

This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1986.

Part II.—Treaties and Tax Legislation.

This part is divided into two subparts as follows: Subpart A, Tax Conventions and Other Related Items, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.

To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts. Also included in this part are Bank Secrecy Act Administrative Rulings. Bank Secrecy Act Administrative Rulings are issued by the Department of the Treasury's Office of the Assistant Secretary (Enforcement).

Part IV.—Items of General Interest.

This part includes notices of proposed rulemakings, disbarment and suspension lists, and announcements.

The last Bulletin for each month includes a cumulative index for the matters published during the preceding months. These monthly indexes are cumulated on a semiannual basis, and are published in the last Bulletin of each semiannual period.

The contents of this publication are not copyrighted and may be reprinted freely. A citation of the Internal Revenue Bulletin as the source would be appropriate.

For sale by the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 42.—Low-Income Housing Credit

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of February 2012. See Rev. Rul. 2012-7, page 362.

Section 280G.—Golden Parachute Payments

Federal short-term, mid-term, and long-term rates are set forth for the month of February 2012. See Rev. Rul. 2012-7, page 362.

Section 382.—Limitation on Net Operating Loss Carryforwards and Certain Built-In Losses Following Ownership Change

The adjusted applicable federal long-term rate is set forth for the month of February 2012. See Rev. Rul. 2012-7, page 362.

Section 412.—Minimum Funding Standards

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of February 2012. See Rev. Rul. 2012-7, page 362.

Section 467.—Certain Payments for the Use of Property or Services

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of February 2012. See Rev. Rul. 2012-7, page 362.

Section 468.—Special Rules for Mining and Solid Waste Reclamation and Closing Costs

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of February 2012. See Rev. Rul. 2012-7, page 362.

Section 482.—Allocation of Income and Deductions Among Taxpayers

Federal short-term, mid-term, and long-term rates are set forth for the month of February 2012. See Rev. Rul. 2012-7, page 362.

Section 483.—Interest on Certain Deferred Payments

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of February 2012. See Rev. Rul. 2012-7, page 362.

Section 642.—Special Rules for Credits and Deductions

Federal short-term, mid-term, and long-term rates are set forth for the month of February 2012. See Rev. Rul. 2012-7, page 362.

Section 807.—Rules for Certain Reserves

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of February 2012. See Rev. Rul. 2012-7, page 362.

Insurance companies; interest rate tables. Prevailing state assumed interest rates are provided for the determination of reserves under section 807 of the Code for contracts issued in 2011 and 2012. Rev. Rul. 92-19 supplemented in part.

Rev. Rul. 2012-6

For purposes of § 807(d)(4) of the Internal Revenue Code, for taxable years beginning after December 31, 2010, this ruling supplements the schedules of prevailing state assumed interest rates set forth in Rev. Rul. 92-19, 1992-1 C.B. 227. This information is to be used by insurance companies in computing their reserves for (1) life insurance and supplementary total and permanent disability benefits, (2) in-

dividual annuities and pure endowments, and (3) group annuities and pure endowments. As § 807(d)(2)(B) requires that the interest rate used to compute these reserves be the greater of (1) the applicable federal interest rate, or (2) the prevailing state assumed interest rate, the table of applicable federal interest rates in Rev. Rul. 92-19 is also supplemented.

Following are supplements to schedules A, B, C, and D to Part III of Rev. Rul. 92-19, providing prevailing state assumed interest rates for insurance products with different features issued in 2011 and 2012, and a supplement to the table in Part IV of Rev. Rul. 92-19, providing the applicable federal interest rates under § 807(d) for 2011 and 2012. This ruling does not supplement Parts I and II of Rev. Rul. 92-19.

This is the twentieth supplement to the interest rates provided in Rev. Rul. 92-19. Earlier supplements were published in Rev. Rul. 93-58, 1993-2 C.B. 241 (interest rates for insurance products issued in 1992 and 1993); Rev. Rul. 94-11, 1994-1 C.B. 196 (1993 and 1994); Rev. Rul. 95-4, 1995-1 C.B. 141 (1994 and 1995); Rev. Rul. 96-2, 1996-1 C.B. 141 (1995 and 1996); Rev. Rul. 97-2, 1997-1 C.B. 134 (1996 and 1997); Rev. Rul. 98-2, 1998-1 C.B. 259 (1997 and 1998); Rev. Rul. 99-10, 1999-1 C.B. 671 (1998 and 1999); Rev. Rul. 2000-17, 2000-1 C.B. 842 (1999 and 2000); Rev. Rul. 2001-11, 2001-1 C.B. 780 (2000 and 2001); Rev. Rul. 2002-12, 2002-1 C.B. 624 (2001 and 2002); Rev. Rul. 2003-24, 2003-1 C.B. 557 (2002 and 2003); Rev. Rul. 2004-14, 2004-1 C.B. 511 (2003 and 2004); Rev. Rul. 2005-29, 2005-1 C.B. 1080 (2004 and 2005); Rev. Rul. 2006-25, 2006-1 C.B. 882 (2005 and 2006); Rev. Rul. 2007-10, 2007-1 C.B. 660 (2006 and 2007); Rev. Rul. 2008-19, 2008-1 C.B. 669 (2007 and 2008); Rev. Rul. 2009-3, 2009-5 I.R.B. 382 (2008 and 2009); Rev. Rul. 2010-7, 2010-8 I.R.B. 417 (2009 and 2010); and Rev. Rul. 2011-23, 2011-43 I.R.B. 585 (2010 and 2011).

Part III. Prevailing State Assumed Interest Rates — Products Issued in Years After 1982*

Schedule A

STATUTORY VALUATION INTEREST RATES
BASED ON THE 1980 AMENDMENTS TO THE
NAIC STANDARD VALUATION LAW

A. Life insurance valuation:

Guarantee Duration (<u>years</u>)	Calendar Year of Issue <u>2012</u>
10 or fewer	4.50**
More than 10 but not more than 20	4.25**
More than 20	4.00**

Source: Rates calculated from the monthly averages, ending June 30, 2011, of Moody's Composite Yield on Seasoned Corporate Bonds.

*The terms used in the schedules in this ruling and in Part III of Rev. Rul. 92-19 are those used in the Standard Valuation Law; the terms are defined in Rev. Rul. 92-19.

**As these rates exceed the applicable federal interest rate for 2012 of 2.89 percent, the valuation interest rate to be used for this product under § 807 is the applicable rate specified in this table.

Part III. Schedule B

STATUTORY VALUATION INTEREST RATES
BASED ON THE 1980 AMENDMENTS TO THE
NAIC STANDARD VALUATION LAW

B. Single premium immediate annuities and annuity benefits involving life contingencies arising from other annuities with cash settlement options and from guaranteed interest contracts with cash settlement options:

<u>Calendar Year of Issue</u>	<u>Valuation Interest Rate</u>
2011	5.00*

Source: Rates calculated from the monthly averages, ending June 30, 2011, of Moody's Composite Yield on Seasoned Corporate Bonds (formerly known as Moody's Corporate Bond Yield Average — Monthly Average Corporates). The terms used in this schedule are those used in the Standard Valuation Law as defined in Rev. Rul. 92-19.

*As this prevailing state assumed interest rate exceeds the applicable federal interest rate for 2011 of 3.46 percent, the valuation interest rate of 5.00 percent is to be used for this product under § 807.

Part III. Schedule C24 — 2011

STATUTORY VALUATION INTEREST RATES
 BASED ON NAIC STANDARD VALUATION LAW
 FOR 2011 CALENDAR YEAR BUSINESS
GOVERNED BY THE 1980 AMENDMENTS

C. Valuation interest rates for other annuities and guaranteed interest contracts that are valued on an issue year basis:

Cash Settlement Options?	Future Interest Guarantee?	Guarantee Duration (years)	Valuation Interest Rate (%) For Plan Type		
			A	B	C
Yes	Yes	5 or fewer	5.00*	4.50*	4.25*
		More than 5, but not more than 10	4.75*	4.50*	4.25*
		More than 10, but not more than 20	4.50*	4.25*	4.00*
		More than 20	4.00*	3.75*	3.75*
Yes	No	5 or fewer	5.00*	4.50*	4.25*
		More than 5, but not more than 10	5.00*	4.50*	4.25*
		More than 10, but not more than 20	4.75*	4.25*	4.25*
		More than 20	4.25*	4.00*	4.00*
No	Yes or No	5 or fewer	5.00*		
		More than 5, but not more than 10	4.75*	NOT APPLICABLE	
		More than 10, but not more than 20	4.50*		
		More than 20	4.00*		

Source: Rates calculated from the monthly averages, ending June 30, 2011, of Moody's Composite Yield on Seasoned Corporate Bonds.

*As these rates exceed the applicable federal interest rate for 2011 of 3.46 percent, the valuation interest rate to be used for this product under § 807 is the applicable rate specified in the above table.

Part III. Schedule D24 — 2011

STATUTORY VALUATION INTEREST RATES
 BASED ON NAIC STANDARD VALUATION LAW
 FOR 2011 CALENDAR YEAR BUSINESS
GOVERNED BY THE 1980 AMENDMENTS

D. Valuation interest rates for other annuities and guaranteed interest contracts that are contracts with cash settlement options and that are valued on a change in fund basis:

Cash Settlement Options?	Future Interest Guarantee?	Guarantee Duration (years)	Valuation Interest Rate For Plan Type		
			A	B	C
Yes	Yes	5 or fewer	5.25*	5.00*	4.25*
		More than 5, but not more than 10	5.25*	5.00*	4.25*
		More than 10, but not more than 20	5.00*	4.75*	4.25*
		More than 20	4.50*	4.50*	4.00*
Yes	No	5 or fewer	5.25*	5.25*	4.50*
		More than 5, but not more than 10	5.25*	5.25*	4.50*
		More than 10, but not more than 20	5.00*	5.00*	4.25*
		More than 20	4.50*	4.50*	4.00*

Source: Rates calculated from the monthly averages, ending June 30, 2011, of Moody's Composite Yield on Seasoned Corporate Bonds.

*As these rates exceed the applicable federal interest rate for 2011 of 3.46 percent, the valuation interest rate to be used for this product under § 807 is the applicable rate specified in the above table.

Part IV. Applicable Federal Interest Rates

TABLE OF APPLICABLE FEDERAL INTEREST RATES FOR PURPOSES OF § 807

<u>Year</u>	<u>Interest Rate</u>
2011	3.46
2012	2.89

Sources: Rev. Rul. 2004–106, 2004–2 C.B. 893, for the 2005 rate; Rev. Rul. 2005–77, 2005–2 C.B. 1071, for the 2006 rate; Rev. Rul. 2006–61, 2006–2 C.B. 1028 for the 2007 rate; Rev. Rul. 2007–70, 2007–2 C.B. 1158 for the 2008 rate; Rev. Rul. 2008–53, 2008–2 C.B. 1231 for the 2009 rate; Rev. Rul. 2009–38, 2009–49 I.R.B. 736 for the 2010 rate; Rev. Rul. 2010–29, 2010–50 I.R.B. 818 for the 2011 rate; and Rev. Rul. 2011–31, 2011–49 I.R.B. 829 for the 2012 rate.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 92–19 is supplemented by the addition to Part III of that ruling of prevailing state assumed interest rates under § 807 for certain insurance products issued in 2011 and 2012 and is further supplemented by an addition to the table in Part IV of Rev. Rul. 92–19 listing applicable federal interest rates. Parts I and II of Rev. Rul. 92–19 are not affected by this ruling.

DRAFTING INFORMATION

The principal author of this revenue ruling is Linda K. Boyd of the Office of Associate Chief Counsel (Financial Institutions and Products). For further information regarding this revenue ruling, contact her at (202) 622–3970 (not a toll-free call).

Section 846.—Discounted Unpaid Losses Defined

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of February 2012. See Rev. Rul. 2012-7, page 362.

Section 954.—Foreign Base Company Income

26 CFR 1.954-3: Foreign base company sales income.

T.D. 9563

Guidance Regarding Foreign Base Company Sales Income

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and removal of temporary regulations.

SUMMARY: This document contains final regulations that provide guidance relating to foreign base company sales income when personal property sold by a controlled foreign corporation (CFC) is purchased, sold, manufactured, produced, constructed, grown or extracted by one or more branches of the CFC. The regulations finalize proposed regulations and withdraw temporary regulations published on December 29, 2008. These regulations, in general, affect controlled foreign corporations and their United States shareholders.

DATES: *Effective Date:* These regulations are effective on December 19, 2011.

Applicability Date: These regulations apply to taxable years of CFCs beginning after June 30, 2009, and for taxable years of United States shareholders in which or with which such taxable years of the CFCs end.

FOR FURTHER INFORMATION
CONTACT: Barbara E. Rasch, (202)
622–3840 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

On February 28, 2008, the IRS and the Treasury Department published a notice of proposed rulemaking in the **Federal Register** (REG–124590–07, 2008–1 C.B. 801 [73 FR 10716], as corrected at 73 FR 20201), which proposed amendments to § 1.954–3, including rules that addressed the application of the section 954(d)(2) branch rules under the foreign base company sales income (FBCSI) rules. Written comments were received in response to the notice of proposed rulemaking, and a public hearing on the proposed regulations was held on July 29, 2008. On December 29, 2008, the IRS and the Treasury Department published final and temporary regulations under section 954(d) (T.D. 9438, 2009–5 I.R.B. 387 [73 FR 79334–01], as corrected at 74 FR 11843–01) in the **Federal Register**. On the same date, the IRS and the Treasury Department published a notice of proposed rulemaking (REG–150066–08, 2009–5 I.R.B. 423 [73 FR 79421–01]) in the **Federal Register** cross-referencing the temporary regulations. The temporary and proposed regulations address the treatment under the FBCSI rules of the sale by a CFC of personal property that is purchased, sold, manufactured, produced, constructed, grown or extracted by one or more branches of the CFC. Written

comments were received, and are available at www.regulations.gov or upon request. A public hearing was not requested and none was held. This Treasury decision adopts the proposed regulation with the changes described below as a final regulation and removes the corresponding temporary regulations.

Explanation of Provisions

These regulations amend the provisions of §1.954-3(b) that address the application of the FBCSI rules to CFCs with branches or similar establishments (branches), and, in particular manufacturing branches.

A. Branch Rule

Section 954(d)(1) defines FBCSI to mean income derived by a CFC in connection with: (i) the purchase of personal property from a related person and its sale to any person; (ii) the sale of personal property to any person on behalf of a related person; (iii) the purchase of personal property from any person and its sale to a related person; or (iv) the purchase of personal property from any person on behalf of a related person, provided (in all of these cases) that the property is manufactured, produced, grown or extracted outside of the CFC's country of organization and is sold for use, consumption or disposition outside of such country. There are certain exceptions to the FBCSI rules, including an exception that applies if a CFC sells personal property that it manufactured, produced, constructed, grew or extracted. See section 954(d)(1)(A), §1.954-3(a)(4).

Section 954(d)(2) applies the FBCSI rules to a CFC that has a branch outside the CFC's country of incorporation (branch rule). The branch rule applies if the CFC carries on purchasing, selling, manufacturing, producing, constructing, growing or extracting activities by or through the branch, and the carrying on of such activities has substantially the same tax effect as if the branch were a wholly-owned subsidiary of the CFC, as provided in regulations. If so, the branch and the remainder of the CFC will be treated as separate corporations for purposes of determining FBCSI of such CFC.

The "substantially same tax effect" determination is made pursuant to a tax rate disparity test set forth in §1.954-3(b)(1)(i)(b) and

§1.954-3(b)(1)(ii)(b). With respect to a sales or purchase branch, the tax rate disparity test is applied by comparing the rate of tax imposed on the income derived from the purchasing or selling activities of the branch with the rate of tax that would apply if the income were earned by the remainder of the CFC. With respect to a manufacturing branch, the tax rate disparity test is applied by comparing the rate of tax imposed on the income derived from the purchasing and selling activities of the CFC with the rate of tax that would apply to such income under the laws of the country in which the manufacturing branch is located.

These final regulations provide guidance on the application of the branch rule, in particular with respect to a CFC that has multiple branches. For example, the regulations set forth rules on how to determine whether a CFC earns FBCSI if purchase and sales activities are conducted by multiple branches and if multiple branches are involved in the manufacture of either a single or multiple items of personal property that is sold by the CFC.

B. Summary of Comments

1. Demonstrably greater contribution

Section 1.954-3T(b)(1)(ii)(c)(3)(iii) provides that if none of the branches or the remainder of a CFC independently satisfies the substantial contribution test, but the CFC as a whole made a substantial contribution, then for purposes of applying the tax rate disparity test, the location of manufacture, production or construction is the "tested manufacturing location" unless the "tested sales location" provided a "demonstrably greater" contribution. Comments were received seeking clarification on the meaning of the word "demonstrably" and expressing concern that it could be interpreted to provide an evidentiary rule regarding the standard of proof required with respect to the determination of the location of manufacture of an item pursuant to §1.954-3T(b)(1)(ii)(c)(3)(iii). The IRS and the Treasury Department did not intend the word "demonstrably" to refer to an elevated standard of proof. In order to eliminate uncertainty, the word "demonstrably" has been deleted from §1.954-3(b)(1)(ii)(c)(3)(iii).

2. Grouping of branches

Comments sought clarification of the rule in §1.954-3T(b)(2)(ii)(a) that generally provides for the grouping of branches that do not have tax rate disparity with a purchasing or selling branch, or with the remainder of the CFC treated as purchasing or selling on behalf of a manufacturing branch. This grouping rule applies for purposes of §1.954-3T(b)(2)(ii), which sets forth the rules that apply after it has been determined that a branch and the remainder of a CFC will be treated as separate corporations. Comments suggested that this grouping rule could be interpreted to group not only the activities of the branches but also the income of those branches and recommended that the rule be clarified by specifically stating that the rule groups the "activities" of the relevant branches.

The rules in §1.954-3T(b)(2)(ii) apply to determine whether the income of a branch or remainder of a CFC is FBCSI rather than to determine the amount of the income of the branch or remainder of the CFC. The purpose of this grouping rule is to allow a CFC to aggregate the activities of branches that do not have tax rate disparity with a sales or purchasing branch (or remainder) when applying the separate corporation analysis to determine whether the sales income of the sales or purchase branch (or remainder) is FBCSI. §1.954-3(b)(1)(ii)(c)(3)(v), *Example 1*. The IRS and the Treasury Department believe that the grouping rule in §1.954-3T(b)(2)(ii)(a) properly aggregates the activities of the relevant branches (or remainder). However, for clarity, the phrase "the activities of" was added to §1.954-3(b)(2)(ii)(a).

C. Deletion of §1.954-3(b)(2)(ii)(d)

The final regulations delete paragraph (d) of §1.954-3(b)(2)(ii), which provided that income that is FBCSI as a result of the application of §1.954-3(b)(1)(i) (purchasing or selling branch rules) is not again classified as FBCSI as a result of the application of §1.954-3(b)(1)(ii) (manufacturing branch rules). This paragraph is no longer needed as a result of the addition of the rule in §1.954-3(b)(1)(ii)(c)(1), which provides that if one or more sales or purchasing branches are used in addition to a

manufacturing branch, then only the manufacturing branch rules apply.

D. Future Guidance

The IRS and the Treasury Department continue to study additional FBCSI issues, and are considering whether to issue additional guidance, including guidance regarding when a branch should be treated as a separate corporation under section 954(d)(2), and the scope of, and relationship between, FBCSI and foreign base company services income. The IRS and the Treasury Department welcome comments on these issues.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866; therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. In addition, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply because the regulations do not impose a collection of information on small entities. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking that preceded these final and temporary regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Barbara E. Rasch of the Office of Associate Chief Counsel (International). However, other personnel from the IRS and the Treasury Department participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for 26 CFR part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.954-3 is amended by:

1. Revising paragraphs (b)(1)(i)(c), (b)(1)(ii)(a), and (b)(1)(ii)(c).
2. Revising paragraphs (b)(2)(i)(b), (b)(2)(ii)(a), and (b)(2)(ii)(b).
3. Removing and reserving paragraph (b)(2)(ii)(d).
4. Revising paragraph (b)(2)(ii)(e).
5. Revising paragraph (b)(4) introductory text.
6. Revising *Example 3* in paragraph (b)(4).
7. Adding *Examples 8* and *9* in paragraph (b)(4).
8. Revising paragraphs (c) and (d).

The revisions and additions read as follows:

§1.954-3 Foreign base company sales income.

* * * * *

(b) * * *

(1) * * *

(i) * * *

(c) *Use of more than one branch.* If a controlled foreign corporation carries on purchasing or selling activities by or through more than one branch or similar establishment located outside the country under the laws of which such corporation is created or organized, then paragraph (b)(1)(i)(b) of this section shall be applied separately to the income derived by each such branch or similar establishment (by treating such purchasing or selling branch or similar establishment as if it were the only branch or similar establishment of the controlled foreign corporation and as if any such other branches or similar establishments were separate corporations) in determining whether the use of such branch or similar establishment has substantially the same tax effect as if such branch or similar establishment were a wholly owned subsidiary corporation of the controlled foreign corporation. See paragraph (b)(1)(ii)(c)(I) of this section for rules applicable to a controlled foreign corporation that carries on purchase or sales activities by or through one or more branches or similar establishments in addition to carrying on manufacturing activities by or through one or more branches or similar establishments.

(ii) *Manufacturing branch—(a) In general.* If a controlled foreign corporation

carries on manufacturing, producing, constructing, growing, or extracting activities by or through a branch or similar establishment located outside the country under the laws of which such corporation is created or organized and the use of the branch or similar establishment for such activities with respect to personal property purchased or sold by or through the remainder of the controlled foreign corporation has substantially the same tax effect as if the branch or similar establishment were a wholly owned subsidiary corporation of such controlled foreign corporation, the branch or similar establishment and the remainder of the controlled foreign corporation will be treated as separate corporations for purposes of determining the foreign base company sales income of such corporation. See section 954(d)(2). The provisions of this paragraph (b)(1)(ii) will apply only if the controlled foreign corporation (including any branches or similar establishments of such controlled foreign corporation) manufactures, produces, or constructs such personal property within the meaning of paragraph (a)(4)(i) of this section, or carries on growing or extracting activities with respect to such personal property.

* * * * *

(c) *Use of more than one branch—(I) Use of one or more sales or purchase branches in addition to a manufacturing branch.* If, with respect to personal property manufactured, produced, constructed, grown, or extracted by or through a branch or similar establishment located outside the country under the laws of which the controlled foreign corporation is created or organized, purchasing or selling activities are carried on by or through more than one branch or similar establishment, or by or through one or more branches or similar establishments located outside such country, of such corporation, then paragraph (b)(1)(ii)(b) of this section shall be applied separately to the income derived by each such purchasing or selling branch or similar establishment (by treating such purchasing or selling branch or similar establishment as though it alone were the remainder of the controlled foreign corporation) for purposes of determining whether the use of such manufacturing, producing, constructing, growing, or extracting branch or similar establishment

has substantially the same tax effect as if such branch or similar establishment were a wholly owned subsidiary corporation of the controlled foreign corporation. If this rule applies, the sales or purchase branch rules contained in paragraph (b)(1)(i) of this section do not apply. The application of this paragraph (b)(1)(ii)(c)(1) is illustrated by the following example:

Example. All activities of controlled foreign corporation conducted through sales branches and manufacturing branch. (i) *Facts.* FS, a controlled foreign corporation organized under the laws of country M, operates three branches. Branch A, located in country A, manufactures Product X under the principles of paragraph (a)(4)(i) of this section. Branch B, located in Country B, sells Product X manufactured by Branch A to customers for use outside of Country B. Branch C, located in Country C sells Product X manufactured by Branch A to customers for use outside of Country C. FS does not conduct any manufacturing or selling activities apart from the activities of Branches A, B and C. Country M imposes an effective rate of tax on sales income of 0%. 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 20%. Country C imposes an effective rate of tax on sales income of 18%.

(ii) *Result.* Pursuant to this paragraph (b)(1)(ii)(c)(1), paragraph (b)(1)(ii)(b) of this section is applied to the sales income derived by Branch B by treating Branch B as though it alone were the remainder of the controlled foreign corporation. The use of Branch B does not have the same tax effect as if Branch B were a wholly owned subsidiary of FS because the tax rate applicable to the income allocated to Branch B under paragraph (b)(1)(ii)(b) of this section (20%) is not 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 Country A (20%), the country in which Branch A is located. In addition, paragraph (b)(1)(ii)(b) of this section is applied separately to the sales income derived by Branch C by treating Branch C as though it alone were the remainder of the controlled foreign corporation. The use of Branch C does not have the same tax effect as if Branch C were a wholly owned subsidiary of FS because the tax rate applicable to the income allocated to Branch C under paragraph (b)(1)(ii)(b) of this section (18%) is not 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 Country A (20%), the country in which Branch A is located. Pursuant to this paragraph (b)(1)(ii)(c)(1), the rules under paragraph (b)(1)(i) of this section for determining whether a sales or purchase branch is treated as a separate corporation from the remainder of the controlled foreign corporation do not apply.

(2) *Use of more than one branch to manufacture, produce, construct, grow, or extract separate items of personal property.* If a controlled foreign corporation carries on manufacturing, producing, constructing, growing, or extracting activities with respect to separate items of per-

sonal property by or through more than one branch or similar establishment located outside the country under the laws of which such corporation is created or organized, then paragraphs (b)(1)(ii)(b) and (c) of this section will be applied separately to each such branch or similar establishment (by treating such manufacturing branch or similar establishment as if it were the only such branch or similar establishment of the controlled foreign corporation and as if any other such branches or similar establishments were separate corporations) for purposes of determining whether the use of such branch or similar establishment has substantially the same tax effect as if such branch or similar establishment were a wholly owned subsidiary corporation of the controlled foreign corporation. The application of this paragraph (b)(1)(ii)(c)(2) is illustrated by the following example:

Example. Multiple branches that satisfy paragraph (a)(4)(i). (i) *Facts.* 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 paragraph (a)(4)(ii) or (iii) of this section. 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%.

(ii) *Result.* Pursuant to this paragraph (b)(1)(ii)(c)(2), paragraph (b)(1)(ii)(b) of this section 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 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.

(3) *Use of more than one manufacturing branch, or one or more manufacturing branches and the remainder of the controlled foreign corporation, to manufacture, produce, or construct the same item of personal property—(i) In general.* This paragraph (b)(1)(ii)(c)(3) applies to determine the location of manufacture, production, or construction of personal property for purposes of applying paragraph (b)(1)(i)(b) or (b)(1)(ii)(b) of this section where more than one branch or similar establishment of a controlled foreign corporation, or one or more branches or similar establishments of a controlled foreign corporation and the remainder of the controlled foreign corporation, each engage in manufacturing, producing, or constructing activities with respect to the same item of personal property which is then sold by the controlled foreign corporation. This paragraph (b)(1)(ii)(c)(3) is applied separately with respect to the income derived by each purchasing or selling branch or similar establishment or purchasing or selling remainder of the controlled foreign corporation as provided under paragraphs (b)(1)(i) and (b)(1)(ii) of this section. The location of manufacture, production, or construction is determined under paragraph (b)(1)(ii)(c)(3)(ii) of this section if one or more branches or similar establishments or the remainder of the controlled foreign corporation independently satisfies paragraph (a)(4)(i) of this section with respect to an item of personal property. The location of manufacture, production, or construction is determined under paragraph (b)(1)(ii)(c)(3)(iii) of this section if none of the branches or similar establishments or the remainder of the controlled foreign corporation independently satisfies paragraph (a)(4)(i) of this section with respect to an item of personal property, but the controlled foreign corporation as a whole makes a substantial contribution to the manufacture, production or construction of that property within the meaning of paragraph (a)(4)(iv) of this section. For purposes of this paragraph (b)(1)(ii)(c)(3), the location of any activity with respect to the manufacture, production, or construction of an item of personal property is determined under paragraph (b)(1)(ii)(c)(3)(iv) of this section. For

purposes of this paragraph (b)(1)(ii)(c)(3), if multiple branches or similar establishments are located in a single jurisdiction, then the activities of those branches will be aggregated for purposes of determining whether a branch or remainder of the controlled foreign corporation satisfies paragraph (a)(4)(i) of this section.

(ii) *Manufacture, production, or construction in one or more locations.* If only one branch or similar establishment or only the remainder of a controlled foreign corporation independently satisfies paragraph (a)(4)(i) of this section with respect to an item of personal property, then that branch or similar establishment or the remainder of the controlled foreign corporation will be the location of manufacture, production, or construction of that property for purposes of applying paragraph (b)(1)(i)(b) or (b)(1)(ii)(b) of this section to the income from the sale of that property. See paragraph (b)(1)(ii)(c)(3)(v) *Example 1* of this section. If more than one branch or similar establishment or one or more branches or similar establishments and the remainder of the controlled foreign corporation, each independently satisfy paragraph (a)(4)(i) of this section with respect to an item of personal property, then the location of manufacture, production, or construction of that property for purposes of applying paragraph (b)(1)(i)(b) or (b)(1)(ii)(b) of this section will be the location of that branch or similar establishment or the jurisdiction under the laws of which the remainder of the controlled foreign corporation is organized that satisfies paragraph (a)(4)(i) of this section and that would, after applying paragraph (b)(1)(ii)(b) of this section to such branch or similar establishment or paragraph (b)(1)(i)(b) of this section to the remainder of the controlled foreign corporation, impose the lowest effective rate of tax on the income allocated to such branch or the remainder of the controlled foreign corporation under such section (that is, either paragraph (b)(1)(i)(b) or (b)(1)(ii)(b) of this section). See paragraph (b)(1)(ii)(c)(3)(v) *Example 2* of this section.

(iii) *No location independently satisfies manufacturing test.* If no branch or similar establishment or the remainder of the controlled foreign corporation independently satisfies paragraph (a)(4)(i) of this section with respect to an item of personal prop-

erty but the controlled foreign corporation as a whole makes a substantial contribution to the manufacture, production, or construction of that property within the meaning of paragraph (a)(4)(iv) of this section, then for purposes of applying paragraph (b)(1)(i)(b) or (b)(1)(ii)(b) of this section, the location of manufacture, production, or construction with respect to the income derived by a purchasing or selling branch or similar establishment or the purchasing or selling remainder of the controlled foreign corporation in connection with the purchase or sale of that property will be the “tested manufacturing location” unless the “tested sales location” provides a greater contribution to the manufacture, production, or construction of the property. The tested manufacturing location is the location of any branch or similar establishment or remainder of the controlled foreign corporation that contributes to the manufacture, production, or construction of the personal property, if any, that would, after applying paragraph (b)(1)(ii)(b) of this section to such branch or similar establishment or paragraph (b)(1)(i)(b) of this section to the remainder of the controlled foreign corporation, be treated as a separate corporation and would impose the lowest effective rate of tax on the income allocated to such branch or similar establishment or to the remainder of the controlled foreign corporation under such section (that is, either paragraph (b)(1)(i)(b) or (b)(1)(ii)(b) of this section). The tested sales location is the location of the purchasing or selling branch or similar establishment or the remainder of the controlled foreign corporation by or through which the purchasing or selling activities are carried on with respect to the personal property. For purposes of this paragraph (b)(1)(ii)(c)(3)(iii), the contribution to the manufacture, production, or construction of the personal property by the tested sales location will be deemed to include the activities of any branch or similar establishment or remainder of the controlled foreign corporation that would not be treated as a corporation separate from the tested sales location after the application of paragraph (b)(1)(i)(b) or (b)(1)(ii)(b) of this section. For purposes of this paragraph (b)(1)(ii)(c)(3)(iii), the contribution of the tested manufacturing location to the manufacture, production, or construction of the personal property

will be deemed to include any activities of any branch or similar establishment or remainder of the controlled foreign corporation that would be treated as a corporation separate from the tested sales location after the application of paragraph (b)(1)(i)(b) or (b)(1)(ii)(b) of this section. Whether the tested sales location provides a greater contribution to the manufacture, production, or construction of the personal property is determined by weighing the relative contributions to the manufacture, production, or construction of that property by the tested sales location and the tested manufacturing location under the facts and circumstances test provided in paragraph (a)(4)(iv) of this section. See paragraph (b)(1)(ii)(c)(3)(v) *Examples 3, 4, 5, and 6* of this section. If the tested sales location provides a greater contribution to the manufacture, production, or construction of the personal property than the tested manufacturing location or if there is no tested manufacturing location, then the tested sales location is the location of manufacture, production, or construction of that property and the rules of paragraphs (b)(1)(i)(a) and (b)(1)(ii)(a) of this section will not apply with respect to the income derived by the tested sales location in connection with the purchase or sale of that property and the use of that purchasing or selling branch or similar establishment or the purchasing or selling remainder will not result in a branch being treated as a separate corporation for purposes of paragraph (b)(2)(ii) of this section.

(iv) *Location of activity.* For purposes of paragraph (b)(1)(ii)(c)(3) of this section, the location of any activity with respect to the manufacture, production, or construction of an item of personal property is the location where the employees of the controlled foreign corporation perform such activity. For example, the location of any activity concerning intellectual property is determined based on where employees of the controlled foreign corporation develop or direct the use or development of the intellectual property, not on the formal assignment of that intellectual property.

(v) *Examples.* The following examples illustrate the application of this paragraph (b)(1)(ii)(c)(3):

Example 1. Multiple branches contribute to the manufacture of a single product, only one branch satisfies paragraph (a)(4)(i). (i) *Facts.* FS is a con-

trolled foreign corporation organized in Country M. FS operates three branches, Branch A, Branch B, and Branch C, located respectively in Country A, Country B, and Country C. Branch A, Branch B, and Branch C each performs different manufacturing activities with respect to the manufacture of Product X. Branch A, through the activities of employees of FS located in Country A, designs Product X. Branch B, through the activities of employees of FS located in Country B, provides quality control and oversight and direction. Branch C, through the activities of employees of FS located in Country C, manufactures Product X (within the meaning of paragraph (a)(4)(ii) or (a)(4)(iii) of this section) using the designs developed by Branch A and under the oversight of the quality control personnel of Branch B. The activities of Branch A and Branch B do not independently satisfy paragraph (a)(4)(i) of this section. Employees of FS located in Country M purchase the raw materials used in the manufacture of Product X from a related person and control the work-in-process and finished goods throughout the manufacturing process. Employees of FS located in Country M also manage the manufacturing costs and capacities related to Product X. Further, employees of FS located in Country M oversee the coordination between the branches. The activities of the remainder of FS in Country M do not independently satisfy paragraph (a)(4)(i) of this section. Employees of FS located in Country M sell Product X to unrelated persons for use outside of Country M. The sales income from the sale of Product X is taxed in Country M at an effective rate of tax of 10%. Country C imposes an effective rate of tax of 20% on sales income.

(ii) *Result.* Country C is the location of manufacture for purposes of applying paragraph (b)(1)(ii)(b) of this section because only the activities of Branch C independently satisfy paragraph (a)(4)(i) of this section. The use of Branch C has substantially the same tax effect as if Branch C were a wholly owned subsidiary corporation of FS because the effective rate of tax on the sales income (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 C is located (20%). Therefore, sales of Product X by the remainder of FS are treated as sales on behalf of Branch C. In determining whether the remainder of FS will qualify for the manufacturing exception under paragraph (a)(4)(iv) of this section, the activities of FS will include the activities of Branch A or Branch B, respectively, if each of those branches would not be treated as a separate corporation under paragraph (b)(1)(ii)(b) of this section, if that paragraph were applied independently to each of Branch A and Branch B. See paragraph (b)(2)(ii)(a) of this section.

Example 2. Multiple branches satisfy paragraph (a)(4)(i) with respect to the same product sold by the controlled foreign corporation. (i) *Facts.* Assume the same facts as in *Example 1*, except for the following. In addition to the design of Product X, Branch A also performs in Country A other manufacturing activities, including those ascribed to FS in *Example 1*, that are sufficient to qualify as manufacturing under paragraph (a)(4)(iv) of this section with respect to Product X. Country A imposes an effective rate of tax of 12% on sales income.

(ii) *Result.* Branch A and Branch C through their activities each independently satisfy the requirements

of paragraph (a)(4)(i) of this section. Therefore, paragraph (b)(1)(ii)(b) of this section is applied by comparing the effective rate of tax imposed on the income from the sales of Product X against the lowest effective rate of tax that would apply to the sales income in either Country A or Country C if paragraph (b)(1)(ii)(b) of this section were applied separately to Branch A and Branch C. Country A imposes the lower effective rate of tax, and therefore, Branch A is treated as the location of manufacture for purposes of applying paragraph (b)(1)(ii)(b) of this section. The effective rate of tax in Country B is not considered because Branch B does not satisfy paragraph (a)(4)(i) of this section. Neither Branch A nor Branch C is treated as a separate corporation because the effective rate of tax on the sales income of FS from the sale of Product X (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 A is located (12%). Sales of Product X by the remainder of the controlled foreign corporation are not treated as made on behalf of any branch.

Example 3. Determining the location of manufacture when manufacturing activities performed by multiple branches and no branch independently satisfies paragraph (a)(4)(i). (i) *Facts.* FS, a controlled foreign corporation organized in Country M, purchases raw materials from a related person. The raw materials are manufactured (under the principles of paragraph (a)(4)(ii) or (a)(4)(iii) of this section) into Product X by CM, an unrelated corporation, pursuant to a contract manufacturing arrangement. CM physically performs the substantial transformation, assembly, or conversion of the raw materials in Country C. FS has two branches, Branch A and Branch B, located in Country A and Country B respectively. Branch A, through the activities of employees of FS located in Country A, designs Product X. Branch B, through the activities of employees of FS located in Country B, controls manufacturing related logistics, provides oversight and direction during the manufacturing process, and controls the raw materials and work-in-process. FS manages the manufacturing costs and capacities related to the manufacture of Product X through employees located in Country M. Further, employees of FS located in Country M oversee the coordination between the branches. Employees of FS located in Country M also sell Product X to unrelated persons for use outside of Country M. Country M imposes an effective rate of tax on sales income of 10%. Country A imposes an effective rate of tax on sales income of 20%, and Country B imposes an effective rate of tax on sales income of 24%. Neither the remainder of FS, nor any branch of FS independently satisfies paragraph (a)(4)(i) of this section. However, under the facts and circumstances of the business, FS as a whole provides a substantial contribution to the manufacture of Product X within the meaning of paragraph (a)(4)(iv) of this section.

(ii) *Result.* Based on the facts, neither the remainder of FS (through the activities of its employees in Country M) nor any branch of FS independently satisfies paragraph (a)(4)(i) of this section with respect to Product X, but FS, as a whole, provides a substantial contribution through the activities of its employees to the manufacture of Product X. The remainder of FS, Branch A, and Branch B each provides a contribution through the activities of employees to the manufacture of Product X. Therefore, FS must de-

termine the location of manufacture under paragraph (b)(1)(ii)(c)(3)(iii) of this section. The tested sales location is Country M because the selling activities with respect to Product X are carried on by the remainder of FS. The location of Branch A is the tested manufacturing location because the effective rate of tax imposed on FS's sales income by 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 Country A (20%), and Country A has the lowest effective rate of tax among the manufacturing branches that would, after applying paragraph (b)(1)(ii)(b) of this section, be treated as a separate corporation. The activities of Branch B will be included in the contribution of Branch A for purposes of determining the location of manufacture of Product X because the effective rate of tax imposed on the sales income by 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 Country B (24%). Under the facts and circumstances of the business, the activities of the remainder of FS would not provide a greater contribution to the manufacture of Product X than the activities of Branch A and Branch B, considered together. Therefore, the location of manufacture is Country A, the location of Branch A.

Example 4. Manufacturing activities performed by multiple branches, no branch independently satisfies paragraph (a)(4)(i), selling activities carried on by remainder of the controlled foreign corporation, remainder contribution includes branch manufacturing activities. (i) *Facts.* The facts are the same as *Example 3*, except that the effective rate of tax on sales income in Country B is 12%. In addition, under the facts of the particular business, the activities of employees of FS located in Country B and Country M, if considered together, would provide a greater contribution to the manufacture of Product X than the activities of employees of FS located in Country A.

(ii) *Result.* Based on the facts, neither the remainder of FS (through activities of its employees in Country M) nor any branch of FS independently satisfies paragraph (a)(4)(i) of this section with respect to Product X, but FS, as a whole, provides a substantial contribution through the activities of its employees to the manufacture of Product X. The remainder of FS, Branch A, and Branch B each provide a contribution through the activities of their employees to the manufacture of Product X. Therefore, FS must determine the location of manufacture under paragraph (b)(1)(ii)(c)(3)(iii) of this section. The tested sales location is Country M because the selling activities with respect to Product X are carried on by the remainder of FS. The location of Branch A is the tested manufacturing location because the effective rate of tax imposed on FS's sales income by 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 Country A (20%), and Branch A is the only branch that would, after applying paragraph (b)(1)(ii)(b) of this section, be treated as a separate corporation. The activities of Branch B will be included in the contribution of the remainder of FS for purposes of determining the location of manufacture of Product X because the effective rate of tax imposed on the sales income by 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 in-

come in Country B (12%). Under a facts and circumstances analysis, considered together, the activities of Branch B and the remainder of FS would provide a greater contribution to the manufacture of Product X than the activities of Branch A. Therefore, the rules of paragraph (b)(1)(ii)(a) of this section will not apply with respect to the income derived by the remainder of FS in connection with the sale of Product X, and neither Branch A nor Branch B will be treated as a separate corporation for purposes of paragraph (b)(2)(ii) of this section.

Example 5. Manufacturing activities performed by multiple branches, no branch independently satisfies paragraph (a)(4)(i), sales carried on by remainder of the controlled foreign corporation and a sales branch. (i) *Facts.* The facts are the same as *Example 3*, except that sales of Product X are also carried on through Branch D in Country D, and Country D imposes a 16% effective rate of tax on sales income. In addition, under the facts and circumstances of the business, the activities of employees of FS located in Country A and Country M, considered together, would provide a greater contribution to the manufacture of Product X than the activities of employees of FS located in Country B.

(ii) *Result.* Based on the facts, neither the remainder of FS nor any branch of FS independently satisfies paragraph (a)(4)(i) of this section with respect to Product X, but FS, as a whole, provides a substantial contribution through the activities of its employees to the manufacture of Product X. The remainder of FS, Branch A, and Branch B each provide a contribution through the activities of their employees to the manufacture of Product X. Therefore, FS must determine the location of manufacture under paragraph (b)(1)(ii)(c)(3)(iii) of this section. Further, pursuant to paragraph (b)(1)(ii)(c)(1) of this section, paragraph (b)(1)(ii)(c)(3)(iii) of this section must be applied separately to the sales income derived by the remainder of FS and Branch D respectively. The results with respect to the income derived by the remainder of FS in connection with the sale of Product X in this *Example 5* are the same as in *Example 3*. However, paragraph (b)(1)(ii)(c)(3)(iii) of this section must also be applied with respect to Branch D because the sale of Product X is also carried on through Branch D. Thus, for purposes of that sales income, the location of Branch D is the tested sales location. The location of Branch B is the tested manufacturing location because the effective rate of tax imposed on Branch D's sales income by Country D (16%) 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 Country B (24%), and Branch B is the only branch that would, after applying paragraph (b)(1)(ii)(b) of this section, be treated as a separate corporation. The manufacturing activities performed in Country M by the remainder of FS and the manufacturing activities performed in Country A by Branch A will be included in Branch D's contribution to the manufacture of Product X for purposes of determining the location of manufacture of Product X with respect to Branch D's sales income because the effective rate of tax imposed on the sales income by Country D (16%) 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 Country M (10%) and Country A (20%). Under the facts and circumstances of the business, the activi-

ties of Branch D, Branch A, and the remainder of FS, considered together, would provide a greater contribution to the manufacture of Product X than the activities of Branch B. Therefore, the rules of paragraph (b)(1)(ii)(a) of this section will not apply with respect to the income derived by Branch D in connection with the sale of Product X and the use of Branch D to sell Product X will not result in a branch being treated as a separate corporation for purposes of paragraph (b)(2)(ii) of this section.

Example 6. Determining the location of manufacture when employees of remainder of controlled foreign corporation travel to location of unrelated contract manufacturer to perform manufacturing activities. (i) *Facts.* FS, a controlled foreign corporation organized in Country M, purchases raw materials from a related person. The raw materials are manufactured (under the principles of paragraph (a)(4)(ii) or (a)(4)(iii) of this section) into Product X by CM, an unrelated corporation, pursuant to a contract manufacturing arrangement. CM physically performs the substantial transformation, assembly, or conversion of the raw materials in Country C. Employees of FS located in Country M sell Product X to unrelated persons for use outside of Country M. Employees of FS located in Country M engage in product design, manage the manufacturing costs and capacities with respect to Product X, and direct the use of intellectual property for the purpose of manufacturing Product X. Quality control and oversight and direction of the manufacturing process are conducted in Country C by employees of FS who are employed in Country M but who regularly travel to Country C. Branch A, located in Country A, is the only branch of FS. Product design with respect to Product X conducted by employees of FS located in Country A is supplemental to the bulk of the design work, which is done by employees of FS located in Country M. At all times, employees of Branch A control the raw materials, work-in-process and finished goods. Employees of FS located in Country A also control manufacturing related logistics with respect to Product X. Country M imposes an effective rate of tax on sales income of 10%. Country A imposes an effective rate of tax on sales income of 20%. Neither the remainder of FS nor Branch A independently satisfies paragraph (a)(4)(i) of this section. However, under the facts and circumstance of the business, FS as a whole (including Branch A) provides a substantial contribution to the manufacture of Product X within the meaning of paragraph (a)(4)(iv) of this section.

(ii) *Result.* Based on the facts, neither the remainder of FS nor Branch A independently satisfies paragraph (a)(4)(i) of this section with respect to Product X, but FS, as a whole, provides a substantial contribution through the activities of its employees to the manufacture of Product X. The remainder of FS and Branch A each provide a contribution through the activities of employees to the manufacture of Product X. Therefore, FS must determine the location of manufacture under paragraph (b)(1)(ii)(c)(3)(iii) of this section. The tested sales location is Country M because the selling activities with respect to Product X are carried on by the remainder of FS. The tested manufacturing location is the location of Branch A because the effective rate of tax imposed on the remainder of FS's sales income by 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 Country A (20%), and Branch A is the only branch that would, after applying paragraph (b)(1)(ii)(b) of this section, be treated as a separate corporation. Although the activities of traveling employees are considered in determining whether FS, as a whole, makes a substantial contribution to the manufacture of Product X under paragraph (a)(4)(iv) of this section, the activities of the employees of FS that are performed in Country C are not taken into consideration in determining whether Country M, the jurisdiction under the laws of which FS is organized, is the location of manufacture under paragraph (b)(1)(ii)(c)(3)(iii) of this section. Activities of employees performed outside the jurisdiction in which the controlled foreign corporation is organized and outside a location in which the controlled foreign corporation maintains a branch or similar establishment, are not considered in determining the location of manufacture. Under the facts and circumstances of the business, the activities of employees of FS performed in Country M do not provide a greater contribution to the manufacture of Product X than the activities of employees of FS performed in Country A. Therefore, the location of manufacture is Country A, the location of Branch A.

(4) *Use of more than one branch to manufacture, produce, construct, grow, or extract separate items of personal property.* For purposes of paragraphs (b)(1)(ii)(c)(2) and (b)(1)(ii)(c)(3) of this section, an *item* of personal property refers to an individual unit of personal property rather than a type or class of personal property.

(2) * * *

(i) * * *

(b) *Activities treated as performed on behalf of the remainder of corporation.* (1) With respect to purchasing or selling activities performed by or through the branch or similar establishment, such purchasing or selling activities will, with respect to personal property manufactured, produced, constructed, grown, or extracted by the remainder of the controlled foreign corporation, be treated as performed on behalf of the remainder of the controlled foreign corporation.

(2) With respect to purchasing or selling activities performed by or through the branch or similar establishment, such purchasing or selling activities will, with respect to personal property (other than property described in paragraph (b)(2)(i)(b)(1) of this section) purchased or sold, or purchased and sold, by the remainder of the controlled foreign corporation (or any branch treated as the remainder of the controlled foreign corporation), be treated as performed on behalf of the remainder of the controlled foreign corporation.

* * * * *

(ii) * * *

(a) Treatment as separate corporations.

The branch or similar establishment will be treated as a wholly owned subsidiary corporation of the controlled foreign corporation, and such branch or similar establishment will be deemed to be incorporated in the country in which it is located. For purposes of applying the rules of this paragraph (b)(2)(ii), a branch or similar establishment of a controlled foreign corporation treated as a separate corporation purchasing or selling on behalf of the remainder of the controlled foreign corporation under paragraph (b)(2)(ii)(b) of this section, or the remainder of the controlled foreign corporation treated as a separate corporation purchasing or selling on behalf of a branch or similar establishment of the controlled foreign corporation under paragraph (b)(2)(ii)(c) of this section, will include the activities of any other branch or similar establishment or remainder of the controlled foreign corporation that would not be treated as a separate corporation (apart from the branch or similar establishment of a controlled foreign corporation that is treated as performing purchasing or selling activities on behalf of the remainder of the controlled foreign corporation under paragraph (b)(2)(ii)(b) of this section or the remainder of the controlled foreign corporation that is treated as performing purchasing or selling activities on behalf of the branch or similar establishment under paragraph (b)(2)(ii)(c) of this section) if the effective rate of tax imposed on the income of the purchasing or selling branch or similar establishment, or purchasing or selling remainder of the controlled foreign corporation, were tested under the principles of paragraph (b)(1)(i)(b) or (b)(1)(ii)(b) of this section against the effective rate of tax that would apply to such income if it were considered derived by such other branch or similar establishment or the remainder of the controlled foreign corporation.

(b) Activities treated as performed on behalf of the remainder of corporation. (1) With respect to purchasing or selling activities performed by or through the branch or similar establishment, such purchasing or selling activities will, with respect to personal property manufactured, produced, constructed, grown, or extracted by the remainder of the controlled foreign

corporation, be treated as performed on behalf of the remainder of the controlled foreign corporation.

(2) With respect to purchasing or selling activities performed by or through the branch or similar establishment, such purchasing or selling activities will, with respect to personal property (other than property described in paragraph (b)(2)(ii)(b)(I) of this section) purchased or sold, or purchased and sold, by the remainder of the controlled foreign corporation (or any branch treated as the remainder of the controlled foreign corporation), be treated as performed on behalf of the remainder of the controlled foreign corporation.

* * * * *

(d) [Reserved].

(e) Comparison with ordinary treatment. Income derived by a branch or similar establishment, or by the remainder of the controlled foreign corporation, will not be foreign base company sales income under paragraph (b) of this section if the income would not be foreign base company sales income if it were derived by a separate controlled foreign corporation under like circumstances.

* * * * *

(4) Illustrations. The application of this paragraph (b) may be illustrated by the following examples:

* * * * *

Example 3. (i) Facts. Corporation E, a controlled foreign corporation incorporated under the laws of foreign Country X, is a wholly owned subsidiary of Corporation D, also a controlled foreign corporation incorporated under the laws of Country X. Corporation E maintains Branch B in foreign Country Y. Both corporations use the calendar year as the taxable year. In 1964, Corporation E's sole activity, carried on through Branch B, consists of the purchase of articles manufactured in Country X by Corporation D, a related person, and the sale of the articles through Branch B to unrelated persons. One hundred percent of the articles sold through Branch B are sold for use outside Country X and 90% are also sold for use outside of Country Y. The income of Corporation E derived by Branch B from such transactions is taxed to Corporation E by Country X only at the time Corporation E distributes such income to Corporation D and is taxed on the basis of what the tax (a 40% effective rate) would have been if the income had been derived in 1964 by Corporation E from sources within Country X from doing business through a permanent establishment therein. Country Y levies an income tax at an effective rate of 50% on income derived from sources within such country, but the income of Branch B for 1964 is effectively taxed by Country Y at a 5% rate since under the laws of such country, only

10% of Branch B's income is derived from sources within such country. Corporation E makes no distributions to Corporation D in 1964.

(ii) Result. In determining foreign base company sales income of Corporation E for 1964, Branch B is treated as a separate wholly owned subsidiary corporation of Corporation E, the 5% rate of tax being less than 90% of, and at least 5 percentage points less than the 40% rate. Income derived by Branch B, treated as a separate corporation, from the purchase from a related person (Corporation D), of personal property manufactured outside of Country Y and sold for use, disposition, or consumption outside of Country Y constitutes foreign base company sales income. If, instead, Corporation D were unrelated to Corporation E, none of the income would be foreign base company sales income because Corporation E would be purchasing from and selling to unrelated persons and if Branch B were treated as a separate corporation it would likewise be purchasing from and selling to unrelated persons. Alternatively, if Corporation D were related to Corporation E, but Branch B manufactured the articles prior to sale under the principles of paragraph (a)(4)(iv) of this section, the income would not be foreign base company sales income because Branch B, treated as a separate corporation, would qualify for the manufacturing exception under paragraph (a)(4) of this section.

* * * * *

Example 8. Uniformly applicable incentive tax rate in one country. (i) Facts. FS is a controlled foreign corporation organized in Country M. FS operates one branch, Branch A, located in Country A. Branch A manufactures Product X within the meaning of paragraph (a)(4)(ii) or (a)(4)(iii) of this section. Raw materials used in the manufacture of Product X are purchased by FS from an unrelated person. FS engages in activities in Country M to sell Product X to a related person for use outside of Country M. Employees of FS located in Country M carry on only sales functions. The effective rate imposed in Country M on the income from the sale of Product X is 10%. Country A generally imposes an effective rate of tax on income of 20%, but imposes a uniformly applicable incentive rate of tax of 10% on manufacturing income and related sales income.

(ii) Result. The use of Branch A to manufacture Product X does not have 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 X 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 A is located (10%). Consequently, pursuant to paragraph (b)(1)(ii)(b) of this section, Branch A is not treated as a separate corporation apart from the remainder of FS for purposes of determining foreign base company sales income.

Example 9. Manufacturing activities performed by multiple branches, no branch independently satisfies paragraph (a)(4)(i), selling activities carried on by remainder of the controlled foreign corporation, some branch manufacturing activities included in remainder contribution. (i) Facts. FS, a controlled foreign corporation organized in Country M, has three branches, Branch A, Branch B, and Branch C, located in Country A, Country B, and Country C respectively. FS purchases raw materials from a related person.

The raw materials are manufactured (under the principles of paragraph (a)(4)(ii) or (a)(4)(iii) of this section) into Product X by CM, an unrelated corporation, pursuant to a contract manufacturing arrangement. CM physically performs the substantial transformation, assembly, or conversion required to manufacture Product X outside of FS's country of organization. FS manages the manufacturing costs and capacities with respect to the manufacture of Product X through employees located in Country M. Further, employees of FS located in Country M oversee the coordination between the branches. Branch A, through the activities of employees of FS located in Country A, designs Product X, controls manufacturing related logistics, and controls the raw materials and work-in-process during the manufacturing process. Branch B, through the activities of employees of FS located in Country B, provides quality control. Branch C, through the activities of employees of FS located in Country C, provides oversight and direction during the manufacturing process. Employees of FS located in Country M sell Product X to unrelated persons for use outside of Country M. Country M imposes an effective rate of tax on sales income of 10%. Country A imposes an effective rate of tax on sales income of 12%. Country B imposes an effective rate of tax on sales income of 24%, and Country C imposes an effective rate of tax on sales income of 25%. None of the remainder of FS, Branch A, Branch B, or Branch C independently satisfies paragraph (a)(4)(i) of this section. However, under the facts and circumstances of the business, FS, as a whole, provides a substantial contribution to the manufacture of Product X within the meaning of paragraph (a)(4)(iv) of this section. Under the facts and circumstances of the business, the activities of the remainder of FS and Branch A, if considered together, would not provide a greater contribution to the manufacture of Product X than the activities of Branch B and Branch C, if considered together. Under the facts and circumstances of the business, however, the activities of the employees of the remainder of FS and Branch A, if considered together, would constitute a substantial contribution to the manufacture of Product X.

(ii) *Result.* Based on the facts, neither the remainder of FS (through activities of its employees in Country M) nor any branch of FS independently satisfies paragraph (a)(4)(i) of this section with respect to Product X, but FS, as a whole, provides a substantial contribution through the activities of its employees to the manufacture of Product X. The remainder of FS, Branch A, Branch B, and Branch C each provide a contribution through the activities of employees to the manufacture of Product X. Therefore, FS must determine the location of manufacture under paragraph (b)(1)(ii)(c)(3)(iii) of this section. The tested sales location is Country M because the selling activities with respect to Product X are carried on by the remainder of FS. The location of Branch B is the tested manufacturing location because the effective rate of tax imposed on FS's sales income by 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 Country B (24%), and Country B has the lowest effective rate of tax among the manufacturing branches that would, after applying paragraph (b)(1)(ii)(b) of this section, be treated as a separate corporation. The manufacturing activities performed in Country A by Branch A will be included

in the contribution of the remainder of FS for purposes of determining the location of manufacture of Product X because the effective rate of tax imposed on the sales income by 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 Country A (12%). The manufacturing activities performed in Country C by Branch C will be included in the contribution of Branch B for purposes of determining the location of manufacture of Product X because the effective rate of tax imposed on the sales income by 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 Country C (25%). Under the facts and circumstances of the business, the manufacturing activities of the remainder of FS and Branch A, considered together, would not provide a greater contribution to the manufacture of Product X than the activities of Branch B and Branch C, considered together. Therefore, the location of manufacture is Country B, the location of Branch B. In determining that Country B is the location of manufacture, it was determined that after applying paragraph (b)(1)(ii)(b) of this section Branch B would be treated as a separate corporation under paragraph (b)(1)(ii)(a) of this section for purposes of determining foreign base company sales income. To determine whether income from the sale of Product X is foreign base company sales income, the remainder of FS takes into account the activities of Branch A because, under paragraph (b)(2)(ii)(a) of this section, Branch A would not be treated as a separate corporation apart from FS. The remainder of FS is considered to have manufactured Product X under paragraph (a)(4)(i) of this section because the manufacturing activities of the remainder of FS and Branch A, considered together, would make a substantial contribution to the manufacture of Product X within the meaning of paragraph (a)(4)(iv) of this section. Therefore, income derived from the sale of Product X by the remainder of FS does not constitute foreign base company sales income.

(c) *Effective/applicability date.* Paragraphs (a)(1)(i), (a)(1)(iii) *Example 1*, (a)(1)(iii) *Example 2*, (a)(2), (a)(4)(i), (a)(4)(ii), (a)(4)(iii), (a)(4)(iv), (a)(6)(i), (b)(1)(i)(c), (b)(1)(ii)(a), (b)(1)(ii)(c), (b)(2)(i)(b), (b)(2)(ii)(a), (b)(2)(ii)(b), (b)(2)(ii)(e), and (b)(4) *Example 3*, (b)(4) *Example 8*, and (b)(4) *Example 9* of this section shall apply to taxable years of controlled foreign corporations beginning after June 30, 2009, and for taxable years of United States shareholders in which or with which such taxable years of the controlled foreign corporations end.

(d) *Application of regulations to earlier taxable years.* A taxpayer may choose to apply these regulations retroactively with respect to its open taxable years that began prior to July 1, 2009. The taxpayer may so choose if and only if the taxpayer and all members of the taxpayer's affiliated group (within the meaning of section 1504(a))

apply these regulations, in their entirety, to the earliest taxable year of each controlled foreign corporation that ends with or within an open taxable year of the taxpayer and to all subsequent taxable years.

§1.954-3T [Removed]

Par. 3. Section 1.954-3T is removed.

Steven T. Miller,
*Deputy Commissioner for
Services and Enforcement.*

Approved December 6, 2011.

Emily S. McMahon,
*Acting Assistant Secretary
of the Treasury (Tax Policy).*

(Filed by the Office of the Federal Register on December 15, 2011, 11:15 a.m., and published in the issue of the Federal Register for December 19, 2011, 76 F.R. 78545)

Section 1274.—Determination of Issue Price in the Case of Certain Debt Instruments Issued for Property

(Also Sections 42, 280G, 382, 412, 467, 468, 482, 483, 642, 807, 846, 1288, 7520, 7872.)

Federal rates; adjusted federal rates; adjusted federal long-term rate and the long-term exempt rate. For purposes of sections 382, 642, 1274, 1288, and other sections of the Code, tables set forth the rates for February 2012.

Rev. Rul. 2012-7

This revenue ruling provides various prescribed rates for federal income tax purposes for February 2012 (the current month). Table 1 contains the short-term, mid-term, and long-term applicable federal rates (AFR) for the current month for purposes of section 1274(d) of the Internal Revenue Code. Table 2 contains the short-term, mid-term, and long-term adjusted applicable federal rates (adjusted AFR) for the current month for purposes of section 1288(b). Table 3 sets forth the adjusted federal long-term rate and the long-term tax-exempt rate described in section 382(f). Table 4 contains the appropriate percentages for determining the low-income housing credit described in section 42(b)(1) for buildings placed in service during the current month. However, under section 42(b)(2),

the applicable percentage for non-federally subsidized new buildings placed in service after July 30, 2008, and before

December 31, 2013, shall not be less than 9%. Finally, Table 5 contains the federal rate for determining the present value of

an annuity, an interest for life or for a term of years, or a remainder or a reversionary interest for purposes of section 7520.

REV. RUL. 2012-7 TABLE 1				
Applicable Federal Rates (AFR) for February 2012				
	<i>Period for Compounding</i>			
	<i>Annual</i>	<i>Semiannual</i>	<i>Quarterly</i>	<i>Monthly</i>
<i>Short-term</i>				
AFR	.19%	.19%	.19%	.19%
110% AFR	.21%	.21%	.21%	.21%
120% AFR	.23%	.23%	.23%	.23%
130% AFR	.25%	.25%	.25%	.25%
<i>Mid-term</i>				
AFR	1.12%	1.12%	1.12%	1.12%
110% AFR	1.23%	1.23%	1.23%	1.23%
120% AFR	1.34%	1.34%	1.34%	1.34%
130% AFR	1.47%	1.46%	1.46%	1.46%
150% AFR	1.69%	1.68%	1.68%	1.67%
175% AFR	1.97%	1.96%	1.96%	1.95%
<i>Long-term</i>				
AFR	2.58%	2.56%	2.55%	2.55%
110% AFR	2.84%	2.82%	2.81%	2.80%
120% AFR	3.09%	3.07%	3.06%	3.05%
130% AFR	3.36%	3.33%	3.32%	3.31%

REV. RUL. 2012-7 TABLE 2				
Adjusted AFR for February 2012				
	<i>Period for Compounding</i>			
	<i>Annual</i>	<i>Semiannual</i>	<i>Quarterly</i>	<i>Monthly</i>
Short-term adjusted AFR	.35%	.35%	.35%	.35%
Mid-term adjusted AFR	1.24%	1.24%	1.24%	1.24%
Long-term adjusted AFR	3.26%	3.23%	3.22%	3.21%

REV. RUL. 2012-7 TABLE 3	
Rates Under Section 382 for February 2012	
Adjusted federal long-term rate for the current month	3.26%
Long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and the prior two months.)	3.55%

REV. RUL. 2012-7 TABLE 4

Appropriate Percentages Under Section 42(b)(1) for February 2012

Note: Under Section 42(b)(2), the applicable percentage for non-federally subsidized new buildings placed in service after July 30, 2008, and before December 31, 2013, shall not be less than 9%.

Appropriate percentage for the 70% present value low-income housing credit	7.42%
Appropriate percentage for the 30% present value low-income housing credit	3.18%

REV. RUL. 2012-7 TABLE 5

Rate Under Section 7520 for February 2012

Applicable federal rate for determining the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest	1.4%
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Section 1288.—Treatment of Original Issue Discount on Tax-Exempt Obligations

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of February 2012. See Rev. Rul. 2012-7, page 362.

Section 7520.—Valuation Tables

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of February 2012. See Rev. Rul. 2012-7, page 362.

Section 7872.—Treatment of Loans With Below-Market Interest Rates

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of February 2012. See Rev. Rul. 2012-7, page 362.

Part III. Administrative, Procedural, and Miscellaneous

Restitution Payments Under the Trafficking Victims Protection Act of 2000

Notice 2012-12

PURPOSE

This notice provides guidance on the federal income tax treatment of mandatory restitution payments awarded under 18 U.S.C. § 1593, as added by § 112(a) of the Trafficking Victims Protection Act of 2000 (the Act), Division A of Pub. L. 106-386, 114 Stat. 1488-89 (2000).

BACKGROUND

Congress enacted the Act “to combat trafficking of persons, a contemporary manifestation of slavery whose victims are predominantly women and children, to ensure just and effective punishment of traffickers, and to protect their victims.” Section 102(a) of the Act. Congress found that “[v]ictims are often forced through physical violence to engage in sex acts or perform slavery-like labor” and that “[s]uch force includes rape and other forms of sexual abuse, torture, starvation, imprisonment, threats, psychological

abuse, and coercion.” Section 102(b)(6) of the Act.

Under 18 U.S.C. §§ 1581 through 1594, as amended, Congress has defined criminal acts relating to peonage, slavery, and trafficking in persons and established the fines and terms of imprisonment for persons convicted of the criminal acts. The criminal acts include (i) holding a person to a condition of peonage; (ii) kidnapping or carrying away a person to sell the person into involuntary servitude or to be held as a slave, (iii) providing or obtaining a person’s services or labor by actual or threatened use of certain means including force, physical restraint, serious harm, and abuse of legal process, and (iv) sex trafficking of children or by force, fraud, or coercion. *See* 18 U.S.C. §§ 1581, 1583, 1589, and 1591.

Under 18 U.S.C. § 1593, a court must order restitution to a victim for any offense committed under 18 U.S.C. §§ 1581 through 1594, directing a defendant to pay the victim the full amount of the victim’s losses. 18 U.S.C. § 1593(b)(1).

The full amount of a victim’s losses includes costs for medical services relating to physical, psychiatric, or psychological care; costs for physical and occupational therapy or rehabilitation; necessary trans-

portation, temporary housing, and child care expenses; lost income; attorneys’ fees and other costs; and other losses the victim suffers as a proximate result of the offense. *See* 18 U.S.C. §§ 1593(b)(3) and 2259(b)(3). Under 18 U.S.C. § 1593(b)(3), a victim’s losses also include the greater of the gross income or value to the defendant of the victim’s services or labor or the value of the victim’s labor as guaranteed under the minimum wage and overtime guarantees of the Fair Labor Standards Act (29 U.S.C. § 201 *et seq.*).

FEDERAL TAX TREATMENT OF BENEFITS

Mandatory restitution payments awarded under 18 U.S.C. § 1593 are excluded from gross income for federal income tax purposes.

DRAFTING INFORMATION

The principal author of this notice is Sheldon Iskow of the Office of Associate Chief Counsel (Income Tax & Accounting). For further information regarding this notice, contact Mr. Iskow at (202) 622-4920 (not a toll-free call).

Part IV. Items of General Interest

Revisions to Publications 1187, 1220, and 1239

Announcement 2012-6

Changes to:

- Publication 1220, *Specifications for Filing Forms 1097, 1098, 1099, 3921, 3922, 5498, and W-2G Electronically* (Rev. 9-2011)
- Publication 1187, *Specification for Filing Form 1042-S, Foreign Person's U.S. Source Income Subject to Withholding, Electronically* (Rev. 10-2011)
- Publication 1239, *Specifications for Filing Form 8027, Employer's Annual Information Return of Tip Income and Allocated Tips, Electronically* (Rev. 10-2011)

The following Part D., Extensions of Time and Waivers, Sec. 1, General-Extension and Sec. 2, Specifications for Filing Extensions of Time Electronically, supersedes the previously printed Part D., Extensions of Time and Waivers, Sec. 1, General-Extension and Sec. 2, Specifications for Filing Extensions of Time Electronically in the above listed publications.

Part D. Extensions of Time and Waivers

Sec. 1. General — Extensions

.01 An extension of time to file may be requested for Forms 1042-S, 1097, 1098, 1099, 3921, 3922, 5498, 8027 and W-2G.

Note: IRS encourages the payer/transmitter community to utilize the online fill-in form in lieu of the paper Form 8809. Requests for more than one payer must be filed through the Filing Information Returns Electronically (FIRE) system using the Fill-in option. No TCC required.

.02 The Fill-in Form 8809 may be completed online via the FIRE System. (See Part B, Sec. 7, for instructions on connecting to the FIRE System.) At the Main Menu, click "Extension of Time Request" and then click "Fill-in Extension Form". This option is only used to request an automatic 30-day extension. Extension

requests completed online via the FIRE System receive an instant response if completed properly and timely. If you are requesting an additional extension, you must submit a paper Form 8809. Requests for an additional extension of time to file information returns are not automatically granted. Requests for additional time are granted only in cases of extreme hardship or catastrophic event. The IRS will only send a letter of explanation approving or denying your additional extension request. (Refer to .11 of this Section.)

.03 A paper Form 8809, *Application for Extension of Time to File Information Returns*, may be submitted to IRS/IRB at the address listed below. This form may be used to request an extension of time to file information returns submitted on paper. A signature is not required when requesting an automatic 30-day extension. Form 8809 may be obtained by calling 1-800-TAX-Form (1-800-829-3676). The form is also available at *IRS.gov*. These requests must be sent using the following address:

Internal Revenue Service
Information Returns Branch
Attn: Extension of Time Coordinator
240 Murall Drive, Mail Stop 4360
Kearneysville, WV 25430

Note: Due to the large volume of mail received by IRS/IRB and the time factor involved in processing Extension of Time (EOT) requests, it is imperative that the attention line be present on all envelopes or packages containing Form 8809.

.04 Requests for extensions of time to file postmarked by the United States Postal Service on or before the due date of the returns, and delivered by United States mail to IRS/IRB after the due date, are treated as timely under the "timely mailing as timely filing" rule. A similar rule applies to designated private delivery services (PDSs). Notice 97-26, 1997-17 I.R.B. 6, provides rules for determining the date that is treated as the postmark date. For items delivered by a non-designated Private Delivery Service (PDS), the actual date of receipt by IRS/IRB will be

used as the filing date. For items delivered by a designated PDS, but through a type of service not designated in Notice 2004-83, 2004-52 I.R.B. 1030, the actual date of receipt by IRS/IRB will be used as the filing date. The timely mailing rule also applies to furnishing statements to recipients and participants.

.05 To be considered, an extension request must be postmarked, transmitted or completed online by the due date of the returns; otherwise, the request will be denied. (See Part A, Sec. 7, for due dates.) If requesting an extension of time to file several types of forms, use one Form 8809; however, Form 8809 or an extension file must be submitted no later than the earliest due date. For example, if requesting an extension of time to file both Forms 1099-INT and 5498, submit Form 8809 on or before February 28.

.06 As soon as it is apparent that a 30-day extension of time to file is needed, an extension request should be submitted. IRS/IRB does not begin processing extension requests until January. It may take up to 30 days for IRS/IRB to respond to a paper extension request. **Extensions completed online via the FIRE System receive instant results.**

.07 Under certain circumstances, a request for an extension of time may be denied. When a denial letter is received, any additional or necessary information must be resubmitted within 20 calendar days.

.08 Requesting an extension of time for multiple payers should be done by completing the online fill-in form via the FIRE System. A separate Form 8809 must be completed online for each payer.

.09 Transmitters requesting an extension of time via an electronic file (see Sec. 3 for the record layout) will receive the file status results online.

.10 If an extension request is approved, the approval notification should be kept on file. **DO NOT** send the approval notification or copy of the approval notification to IRS/IRB or to the service center where the paper returns are filed.

.11 If an additional extension of time is needed, a Form 8809 and/or extension file must be sent by the initial extended due date. Check line 3 on the form to indicate that an additional extension is be-

ing requested. Failure to properly complete and **sign** Form 8809 may cause delays in processing the request or result in a denial. Carefully read and follow the instructions on the back of Form 8809. A second 30-day extension will be approved only in cases of extreme hardship or catastrophic event. Be sure to include the reason an additional extension is needed. **If requesting a second 30-day extension of time, submit the information return files as soon as prepared. Do not wait for IRS/IRB's response to your second extension request.**

Sec. 2. Specifications for Filing Extensions of Time Electronically

.01 The specifications in Sec. 3 include the required 200-byte record layout for extensions of time to file requests submitted electronically. Also included are the instructions for the information that is to be entered in the record. **Filers are advised to read this section in its entirety to ensure proper filing.**

.02 If a filer does not have an IRS/IRB assigned Transmitter Control Code (TCC), Form 4419, *Application for Filing Information Returns Electronically (FIRE)* **must** be submitted to obtain a TCC. This number **must** be used to submit an exten-

sion request electronically. (See Part A, Sec. 6.)

.03 If you are requesting an additional extension, you must fax a signed Form 8809 the same day as the transmission. Be sure to include the reason an additional extension is needed.

.04 Do not submit tax year 2011 extension requests filed electronically before *January 4, 2012*.

Changes to :

Publication 1220, *Specifications for Filing Forms 1097, 1098, 1099, 3921, 3922, 5498, and W-2G Electronically* (Rev. 9-2011)

Part C, Section 7 for Form 3921 & Form 3922:

- Payee "B" Record for Form 3921, *Exercise of an Incentive Stock Option Under Section 422(b)*,
 - Field Positions 547-554, Date Option Granted, is a Required Field
 - Field Positions 555-562, Date Option Exercised, is a Required Field
 - Field Positions 563-570, Number of Shares Transferred, is a Required Field
- Payee "B" Record for Form 3922, *Transfer of Stock Acquired Through an*

Employee Stock Purchase Plan Under Section 423(c),

- Field Position 547-554, Date Option Granted to Transferor, is a Required Field
- Field Position 555-562, Date Option Exercised by Transferor, is a Required Field
- Field Position 563-570, Number of Shares Transferred, is a Required Field
- Field Position 571-578, Date Legal Title Transferred by Transferor, is a Required Field

Correction to Revenue Procedure 2012-8

Announcement 2012-7

Revenue Procedure 2012-8 as published on January 3, 2012 (2012-1 I.R.B. 235) contains a typographical error in section 6.07(5). The error is that section 6.07(5) refers to Notice 2011-34. The correct Notice is Notice 2011-43. Section 6.07(5) is amended to delete "Notice 2011-34" and replace it with "Notice 2011-43."

Definition of Terms

Revenue rulings and revenue procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified*, below).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A

and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in laws or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in a new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1986 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance

of a prior ruling, a combination of terms is used. For example, *modified* and *superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case, the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A—Individual.
Acq.—Acquiescence.
B—Individual.
BE—Beneficiary.
BK—Bank.
B.T.A.—Board of Tax Appeals.
C—Individual.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
CI—City.
COOP—Cooperative.
Ct.D.—Court Decision.
CY—County.
D—Decedent.
DC—Dummy Corporation.
DE—Donee.
Del. Order—Delegation Order.
DISC—Domestic International Sales Corporation.
DR—Donor.
E—Estate.
EE—Employee.
E.O.—Executive Order.

ER—Employer.
ERISA—Employee Retirement Income Security Act.
EX—Executor.
F—Fiduciary.
FC—Foreign Country.
FICA—Federal Insurance Contributions Act.
FISC—Foreign International Sales Company.
FPH—Foreign Personal Holding Company.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
FX—Foreign corporation.
G.C.M.—Chief Counsel's Memorandum.
GE—Grantee.
GP—General Partner.
GR—Grantor.
IC—Insurance Company.
I.R.B.—Internal Revenue Bulletin.
LE—Lessee.
LP—Limited Partner.
LR—Lessor.
M—Minor.
Nonacq.—Nonacquiescence.
O—Organization.
P—Parent Corporation.
PHC—Personal Holding Company.
PO—Possession of the U.S.
PR—Partner.

PRS—Partnership.
PTE—Prohibited Transaction Exemption.
Pub. L.—Public Law.
REIT—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
S—Subsidiary.
S.P.R.—Statement of Procedural Rules.
Stat.—Statutes at Large.
T—Target Corporation.
T.C.—Tax Court.
T.D.—Treasury Decision.
TFE—Transferee.
TFR—Transferor.
T.I.R.—Technical Information Release.
TP—Taxpayer.
TR—Trust.
TT—Trustee.
U.S.C.—United States Code.
X—Corporation.
Y—Corporation.
Z—Corporation.

Numerical Finding List¹

Bulletins 2012–1 through 2012–6

Announcements:

2012-1, 2012-1 I.R.B. 249
2012-2, 2012-2 I.R.B. 285
2012-3, 2012-4 I.R.B. 335
2012-4, 2012-4 I.R.B. 335
2012-5, 2012-5 I.R.B. 348
2012-6, 2012-6 I.R.B. 366
2012-7, 2012-6 I.R.B. 367

Notices:

2012-1, 2012-2 I.R.B. 260
2012-3, 2012-3 I.R.B. 289
2012-4, 2012-3 I.R.B. 290
2012-5, 2012-3 I.R.B. 291
2012-6, 2012-3 I.R.B. 293
2012-7, 2012-4 I.R.B. 308
2012-8, 2012-4 I.R.B. 309
2012-9, 2012-4 I.R.B. 315
2012-10, 2012-5 I.R.B. 343
2012-11, 2012-5 I.R.B. 346
2012-12, 2012-6 I.R.B. 365

Proposed Regulations:

REG-149625-10, 2012-2 I.R.B. 279
REG-102988-11, 2012-4 I.R.B. 326
REG-130777-11, 2012-5 I.R.B. 347

Revenue Procedures:

2012-1, 2012-1 I.R.B. 1
2012-2, 2012-1 I.R.B. 92
2012-3, 2012-1 I.R.B. 113
2012-4, 2012-1 I.R.B. 125
2012-5, 2012-1 I.R.B. 169
2012-6, 2012-1 I.R.B. 197
2012-7, 2012-1 I.R.B. 232
2012-8, 2012-1 I.R.B. 235
2012-9, 2012-2 I.R.B. 261
2012-10, 2012-2 I.R.B. 273
2012-12, 2012-2 I.R.B. 275
2012-13, 2012-3 I.R.B. 295
2012-14, 2012-3 I.R.B. 296

Revenue Rulings:

2012-1, 2012-2 I.R.B. 255
2012-2, 2012-3 I.R.B. 286
2012-5, 2012-5 I.R.B. 337
2012-6, 2012-6 I.R.B. 349
2012-7, 2012-6 I.R.B. 362

Treasury Decisions:

9559, 2012-2 I.R.B. 252
9560, 2012-4 I.R.B. 299

Treasury Decisions— Continued:

9561, 2012-5 I.R.B. 341
9562, 2012-5 I.R.B. 339
9563, 2012-6 I.R.B. 354

¹ A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2011–27 through 2011–52 is in Internal Revenue Bulletin 2011–52, dated December 27, 2011.

Finding List of Current Actions on Previously Published Items¹

Bulletins 2012–1 through 2012–6

Notices:

2010-88

As modified by Ann. 2011-40, is superseded by Notice 2012-1, 2012-2 I.R.B. 260

2011-28

Superseded by Notice 2012-9, 2012-4 I.R.B. 315

Revenue Procedures:

2003-61

Superseded by Notice 2012-8, 2012-4 I.R.B. 309

2007-44

Modified by Ann. 2012-3, 2012-4 I.R.B. 335

2011-1

Superseded by Rev. Proc. 2012-1, 2012-1 I.R.B. 1

2011-2

Superseded by Rev. Proc. 2012-2, 2012-1 I.R.B. 92

2011-3

Superseded by Rev. Proc. 2012-3, 2012-1 I.R.B. 113

2011-4

Superseded by Rev. Proc. 2012-4, 2012-1 I.R.B. 125

2011-5

Superseded by Rev. Proc. 2012-5, 2012-1 I.R.B. 169

2011-6

Superseded by Rev. Proc. 2012-6, 2012-1 I.R.B. 197

2011-7

Superseded by Rev. Proc. 2012-7, 2012-1 I.R.B. 232

2011-8

Superseded by Rev. Proc. 2012-8, 2012-1 I.R.B. 235

2011-9

Superseded by Rev. Proc. 2012-9, 2012-2 I.R.B. 261

2011-10

Superseded by Rev. Proc. 2012-10, 2012-2 I.R.B. 273

Revenue Procedures— Continued:

2011-40

Corrected by Ann. 2012-6, 2012-6 I.R.B. 366

2011-49

Modified by Ann. 2012-3, 2012-4 I.R.B. 335

2011-50

Corrected by Ann. 2012-6, 2012-6 I.R.B. 366

2011-51

Corrected by Ann. 2012-6, 2012-6 I.R.B. 366

2012-8

Corrected by Ann. 2012-7, 2012-6 I.R.B. 367

Revenue Rulings:

92-19

Supplemented in part by Rev. Rul. 2012-6, 2012-6 I.R.B. 349

2008-40

Modified by Notice 2012-6, 2012-3 I.R.B. 293

2011-1

Modified by Notice 2012-6, 2012-3 I.R.B. 293

Treasury Decision:

9517

Corrected by Ann. 2012-4, 2012-4 I.R.B. 335
Ann. 2012-5, 2012-5 I.R.B. 348

¹ A cumulative list of current actions on previously published items in Internal Revenue Bulletins 2011–27 through 2011–52 is in Internal Revenue Bulletin 2011–52, dated December 27, 2011.

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