

Dear _____ :

This is in response to a letter dated September 20, 2012, submitted by your authorized representative that requested a ruling on behalf of Taxpayer with respect to payments received by a branch of Foreign Partnership from the sale of Products in Country T. The ruling contained in this letter is based upon information and representations submitted on behalf of Taxpayer by its authorized representative, and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of this request for ruling, such material is subject to verification on examination. The information submitted in the request is substantially as set forth below.

FACTS:

Taxpayer, a company organized under the laws of State, and its subsidiaries form a U.S. based multinational company headquartered in the United States, with manufacturing, sales and services operations around the world. Taxpayer, as the U.S. parent company, owns several entities located throughout the world that facilitate the group's worldwide manufacturing, sales and service operations.

Taxpayer wholly owns Domestic Subsidiary, a company organized under the laws of State and treated as a corporation for U.S. federal income tax purposes. Taxpayer and Domestic Subsidiary jointly own FSub-1, a company organized under the laws of Country S and treated as a corporation for U.S. federal income tax purposes. FSub-1 wholly owns FSub-2, a company organized under the laws of Country T and treated as a corporation for U.S. federal income tax purposes. FSub-2, in turn, wholly owns FSub-3, a company organized under the laws of Country T and treated as a corporation for U.S. federal income tax purposes.

In addition, Taxpayer directly and indirectly wholly owns several other foreign entities that are treated as corporations for U.S. federal income tax purposes (collectively, "Partners"). All of the Partners are organized in jurisdictions other than Country T and Country U. The Partners, either directly or through other foreign entities that are treated as disregarded entities for U.S. federal income tax purposes, collectively wholly own Foreign Partnership, an entity organized under the laws of Country V that elected to be treated as a partnership for U.S. federal income tax purposes. Foreign Partnership operates a legal branch in Country U, which is treated as a branch for U.S. federal income tax purposes ("Branch").

Foreign Partnership is the global principal for property manufactured in Country W, Country X, Country Y and Country Z.

Taxpayer, through its subsidiaries, manufactures Products, as well as other products, including Additional Products, in Country T. With respect to Products sold in Country T,

the following entities perform the following functions: (i) Branch operates as a Country U-based principal that provides overall support to the manufacture, marketing and sale of Products; (ii) FSub-3 operates as a cost-plus, limited risk manufacturer of Products; and (iii) FSub-2 operates as a Country T-based principal and distributor of Products purchased from FSub-3.

Generally, with respect to Products sold in Country T, FSub-3 purchases raw materials from both related and unrelated suppliers and performs manufacturing activities to turn the raw materials into finished products. Branch, through the activities of its employees located in Country U, also performs manufacturing activities with respect to the Products. FSub-3 then sells the manufactured Products to FSub-2, at a price that allows FSub-3 to earn a cost-plus manufacturing return. Thereafter, FSub-2 sells the Products to unrelated third party dealers in Country T at an established “dealer net price” on the sale of the Products. Branch performs selling activities with respect to the sale of the Products in Country T.

FSub-2 remits a payment to Branch equal to a percentage of the proceeds from the sale of the Products in Country T, which can vary, in order to compensate Branch for its role in the manufacturing, marketing and selling of Products in Country T. Although Branch is significantly involved in manufacturing, marketing and selling activities with respect to the Products, it never takes legal title to the raw materials, work in process or finished goods for Products that are sold in Country T.

REPRESENTATIONS:

Taxpayer makes the following representations:

- (a) FSub-1, FSub-2, FSub-3 and Partners are each properly treated as a controlled foreign corporation (“CFC”) within the meaning of section 957(a) of the Internal Revenue Code.
- (b) FSub-3’s manufacturing activities with respect to Products sold in Country T constitute manufacturing within the meaning of Treas. Reg. §1.954-3(a)(4)(ii) or (iii).
- (c) Branch makes a substantial contribution to the manufacture, production or construction of Products sold in Country T within the meaning of §1.954-3(a)(4)(iv).
- (d) Other than the employees of Branch, no other employees of Foreign Partnership or Partners perform material purchasing, manufacturing or selling activities with respect to Products sold in Country T.
- (e) Branch’s income from the payments received from FSub-2 is derived from Branch’s contributions to the manufacture and sale of Products in Country T.

- (f) Products sold in Country T are sold for “use, consumption, or disposition” in Country T within the meaning of Treas. Reg. §1.954-3(a)(3).
- (g) In all cases in which a CFC owned by Taxpayer derives income (whether in the form of profits, commission, fees or otherwise) in connection with the sale of personal property to any person on behalf of a related person or the purchase of personal property from any person on behalf of a related person, Taxpayer will treat the income as foreign base company sales income (“FBCSI”) within the meaning of section 954(d), subject to the applicable exceptions in section 954(d) and the regulations thereunder, including §1.954-3(a)(4)(iv), regardless of whether the income could constitute foreign base company services income within the meaning of section 954(e) (without taking into account any exceptions in section 954(e)).

RULING REQUESTED:

Although Branch does not take or pass legal title to Products sold in Country T, the income from the payments received by Branch from the sale of Products is excluded from FBCSI pursuant to Treas. Reg. §1.954-3(a)(4)(i) because Branch makes a substantial contribution through the activities of its employees to the manufacture, production or construction of the Products within the meaning of Treas. Reg. §1.954-3(a)(4)(iv).

LAW:

Section 951(b) defines a U.S. shareholder, with respect to any foreign corporation, as a United States person (as defined in section 957(c)) who owns (directly, indirectly or constructively) 10 percent or more of the total combined voting power of all classes of stock entitled to vote of the foreign corporation. (“U.S. Shareholder”).

Section 957(a) defines a CFC as a foreign corporation with respect to which more than 50 percent of the total combined voting power of all classes of stock entitled to vote or the total value of the stock of the corporation is owned (directly, indirectly or constructively) by U.S. Shareholders.

Generally, section 951(a) provides that if a foreign corporation is a CFC for a period of thirty days or more during any taxable year, a U.S. Shareholder of the CFC must include in gross income its pro rata share of the CFC’s subpart F income.

Section 952(a)(2) defines subpart F income to include foreign base company income (“FBCI”).

Section 954(a)(2) defines FBCI to include FBCSI as defined in section 954(d).

Section 954(d)(1) defines FBCSI to mean income (whether in the form of profits, commissions, fees, or otherwise) derived in connection with the purchase of personal property from a related person and its sale to any person, the sale of personal property to any person on behalf of a related person, the purchase of personal property from any person and its sale to a related person, or the purchase of personal property from any person on behalf of a related person where (A) the property which is purchased (or in the case of property sold on behalf of a related person, the property which is sold) is manufactured, produced, grown or extracted outside the country under the laws of which the CFC is created or organized, and (B) the property is sold for use, consumption or disposition outside the foreign country, or, in the case of property purchased on behalf of a related person, is purchased for use, consumption or disposition outside the foreign country.

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

Treas. Reg. §1.954-3(a)(1)(i) provides that FBCSI of a CFC, except as provided in Treas. Reg. §1.954-3(a)(2), (a)(3) and (a)(4), consists of gross income (whether in the form of profits, commissions, fees or otherwise) derived in connection with the purchase of personal property from a related person and its sale to any person, the sale of personal property to any person on behalf of a related person, the purchase of personal property from any person and its sale to a related person, or the purchase of personal property from any person on behalf of a related person.

Treas. Reg. §1.954-3(a)(4)(i) provides that FBCSI does not include income of a CFC derived in connection with the sale of personal property manufactured, produced or constructed by the corporation. A CFC will have manufactured, produced or constructed personal property which the corporation sells only if the corporation satisfies the provisions of Treas. Reg. §1.954-3(a)(4)(ii), (iii) or (iv) through the activities of its employees (as defined in Treas. Reg. §31.3121(d)-1(c)) with respect to the property.

Treas. Reg. §1.954-3(a)(4)(ii) provides that if personal property purchased by a foreign corporation is substantially transformed by the foreign corporation prior to sale, the property sold by the selling corporation is manufactured, produced or constructed by the selling corporation.

Treas. Reg. §1.954-3(a)(4)(iii) provides that if purchased property is used as a component part of personal property that is sold, the sale of the property will be treated

as the sale of a manufactured product, rather than the sale of component parts, if the assembly or conversion of the component parts into the final product by the selling corporation involves activities that are substantial in nature and generally considered to constitute the manufacture, production or construction of property.

Treas. Reg. §1.954-3(a)(4)(iv) provides that if an item of personal property would be considered manufactured, produced or constructed (under the principles of Treas. Reg. §1.954-3(a)(4)(ii) or (a)(4)(iii)) prior to sale by the CFC had all of the manufacturing, producing and constructing activities undertaken with respect to that property prior to sale been undertaken by the CFC through the activities of its employees, then Treas. Reg. §1.954-3(a)(4)(iv) applies. If Treas. Reg. §1.954-3(a)(4)(iv) applies and if the facts and circumstances evince that the CFC makes a substantial contribution through the activities of its employees to the manufacture, production or construction of the personal property sold, then the personal property sold by the CFC is manufactured, produced or constructed by the CFC.

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

Treas. Reg. §1.954-1(g)(1) provides that unless otherwise provided, to determine the extent to which a CFC's distributive share of any item of gross income of a partnership would have been subpart F income if received by it directly, under Treas. Reg. §1.952-1(g), if a provision of subpart F requires a determination of whether an entity is a related person, within the meaning of section 954(d)(3), or whether an activity occurred within or outside the country under the laws of which the CFC is created or organized, this determination is made by reference to the CFC and not by reference to the partnership.

Treas. Reg. §1.954-3(a)(6) provides that to determine the extent to which a CFC's distributive share of any item of gross income of a partnership would have been FBCSI if received by it directly, under Treas. Reg. §1.952-1(g), the property sold will be considered to be manufactured, produced or constructed by the CFC, within the meaning of Treas. Reg. §1.954-3(a)(4)(i), only if the manufacturing exception of Treas. Reg. §1.954-3(a)(4)(i) would have applied to exclude the income from FBCSI if the CFC had earned the income directly, determined by taking into account only the activities of the employees of, and property owned by, the partnership.

ANALYSIS:

Taxpayer is a U.S. Shareholder with respect to each Partner, each of which is a CFC. Accordingly, Taxpayer is required to include amounts in income under section 951(a)(1) with respect to Partners, including its pro rata share of Partners' subpart F income, which includes FBCSI. Unless an exception applies, FBCSI includes income derived in

connection with the purchase of personal property from any person and its sale to a related person, and the sale of personal property to any person on behalf of a related person.

Each Partner's distributive share of gross income of Foreign Partnership is FBCSI to the extent the item of income would have been FBCSI if received by the Partner directly. Income from the payments received by Branch is included in Foreign Partnership's gross income.

Branch receives payments from FSub-2 in compensation for Branch's role in the manufacturing, marketing and selling of Products in Country T. Unless the substantial contribution exception in Treas. Reg. §1.954-3(a)(4)(iv) applies, each Partner's distributive share of income from the payments received by Branch would meet the definition of FBCSI even though Branch does not take title to the Products because the income is derived in connection with a sale on behalf of a related person, and the Products are both physically manufactured and sold for use, consumption or disposition in Country T, and therefore outside of the countries of organization of the Partners.

Taxpayer represents that Branch makes a substantial contribution to the manufacture, production or construction of Products sold in Country T within the meaning of Treas. Reg. §1.954-3(a)(4)(iv).

Treas. Reg. §1.954-3(a)(4)(i) provides that FBCSI does not include income of a CFC derived in connection with the "sale" of personal property manufactured, produced or constructed by the corporation, and further provides that a CFC will have manufactured, produced or constructed personal property that the corporation "sells" only if the corporation satisfies the exceptions set forth at Treas. Reg. §1.954-3(a)(4)(ii), (iii) or (iv). Similarly, Treas. Reg. §1.954-3(a)(4)(iv) provides that the substantial contribution exception applies if a CFC makes a substantial contribution to the manufacture, production or construction of property prior to "sale" by the CFC. The references in Treas. Reg. §1.954-3(a)(4)(i) and (iv) to a CFC being a selling entity (e.g., "sells" and prior to "sale") should be construed consistently with the statutory definition of FBCSI to refer to any case in which the CFC derives income from selling activities that would otherwise be FBCSI. Accordingly, "sale" and "sells" and "sold" in Treas. Reg. §1.954-3(a)(4)(i) and (iv) are interpreted to include the performance of sales activities on behalf of a related person.

RULING:

Based on the information submitted and the representations made, we rule as follows:

Although Branch does not take or pass legal title to Products sold in Country T, the income from the payments received by Branch from the sale of the Products is excluded from FBCSI pursuant to Treas. Reg. §1.954-3(a)(4)(i) because Branch makes a

substantial contribution through the activities of its employees to the manufacture, production or construction of the Products within the meaning of Treas. Reg. §1.954-3(a)(4)(iv).

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This private letter ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter ruling is being sent to your authorized representative.

A copy of this letter ruling must be attached to any federal income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

Sincerely,

Jeffery G. Mitchell
Branch Chief, Branch 2
(International)