

**Internal Revenue Service**

Department of the Treasury  
Washington, DC 20224

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Person To Contact: \_\_\_\_\_, ID No.

Telephone Number:

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Date:  
April 15, 2013

TY:

Legend

Taxpayer =  
EIN =

FSub =

FDE =

State =

Country X =

Products =

Q =

Dear \_\_\_\_\_ :

This is in response to a letter dated October 15, 2012, submitted by your authorized representative that requested a ruling on behalf of Taxpayer with respect to payments received by FDE in return for performing procurement related activities for Taxpayer and some of its foreign affiliates. 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, with manufacturing, sales, and services operations around the world. Taxpayer indirectly owns several entities located throughout the world that facilitate the group's worldwide manufacturing, sales, and services operations.

Taxpayer indirectly owns FSub, a company organized under the laws of Country X and treated as a corporation for U.S. federal income tax purposes. FSub owns FDE, a company organized under the laws of Country X; FDE is disregarded as an entity separate from FSub for U.S. federal income tax purposes.

Taxpayer and certain of its foreign subsidiaries purchase Products from unrelated foreign manufacturers ("Vendors"). The Products are manufactured outside the U.S. and sold to customers both inside and outside the U.S.

Taxpayer, its foreign affiliates, and FDE have entered into a buying agency agreement under which FDE performs various procurement related activities. FDE is responsible for ensuring that the Products purchased by Taxpayer and its foreign affiliates from the Vendors meet Taxpayer's standard of design, image, quality, vendor compliance, and brand. Taxpayer and its foreign affiliates pay FDE a commission, based on a percentage of the price of ordered merchandise received by the buyer, for the procurement related activities FDE performs. FDE has approximately Q employees in Country X that perform these procurement related activities.

## REPRESENTATIONS:

Taxpayer makes the following representations:

- (a) FSub is properly treated as a controlled foreign corporation ("CFC") within the meaning of section 957(a) of the Internal Revenue Code.
- (b) The Vendors' manufacturing activities with respect to the Products constitute manufacturing within the meaning of Treas. Reg. §1.954-3(a)(4)(ii) or (iii).
- (c) FDE makes a substantial contribution through its employees to the manufacture, production or construction of Products within the meaning of §1.954-3(a)(4)(iv).
- (d) FDE's income from the payments received from Taxpayer and its foreign affiliates is derived from FDE's contributions to the manufacture and sale of Products.

(e) In all cases in which a CFC controlled 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:

The income from the payments received by FDE for the procurement related activities it performs is excluded from FBCSI pursuant to Treas. Reg. §1.954-3(a)(4)(i) because FDE 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..

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.

#### ANALYSIS:

Taxpayer is a U.S. Shareholder of FSub, and FSub is a CFC. Accordingly, Taxpayer is required to include amounts in income under section 951(a)(1), including its pro rata share of FSub's 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 on behalf of a related person. Section 954(d).

FDE receives payments from Taxpayer and some of its foreign affiliates as compensation for FDE's performance of procurement related activities with respect to Products. Unless the substantial contribution exception in Treas. Reg. §1.954-3(a)(iv) applies, the income FDE receives for the performance of procurement related activities would meet the definition of FBCSI even though FDE does not take title to the Products because the income is derived in connection with a purchase on behalf of a related person.

Section 954(d) provides that FBCSI includes income derived in connection with the purchase or sale of property 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 CFC. Treas. Reg. §1.954-3(a)(4)(iv) provides that a CFC will be considered to have manufactured, produced or constructed property if the CFC makes a substantial contribution to the manufacture, production or construction of property prior to sale by the CFC. Here, Taxpayer represents that FDE makes a substantial contribution to the manufacture, production, or construction of Products within the meaning of Treas. Reg. §1.954-3(a)(4)(iv). The exceptions to FBCSI for property manufactured, produced, or constructed by the CFC are construed to apply consistently with the statutory definition of FBCSI. Accordingly, Treas. Reg. §1.954-3(a)(4)(i) and (iv) are interpreted to include the performance of purchasing activities on behalf of a related person. Thus, Treas. Reg. §1.954-3(a)(4)(i) and (iv) apply to any case in which the CFC makes a substantial contribution to the manufacture of property and the CFC derives income from purchasing activities in connection with that property that would otherwise be FBCSI.

## RULING:

Based on the information submitted and the representations made, including the representation that FDE makes a substantial contribution through the activities of its employees to the manufacture, production or construction of Products within the meaning of Treas. Reg. §1.954-3(a)(4)(iv), the income from the payments received by FDE for the performance of procurement related activities in connection with Products is excluded from FBCSI pursuant to Treas. Reg. §1.954-3(a)(4)(i).

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)

cc: