

# *US Outbound Tax Newsalert*

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## *IRS finalizes foreign base company sales income regulations*

### *Overview*

The IRS today issued final regulations amending Reg. Sec. 1.954-3(b) that address the application of the foreign base company sales income ("FBCSI") rules to controlled foreign corporations ("CFCs") with branches or similar establishments, and, in particular, manufacturing branches. The regulations finalize proposed regulations and withdraw temporary regulations issued in December 2008 with minor clarifying changes. Regulations under section 954(d)(1), including regulations addressing the substantial contribution test, were previously finalized in December 2008.

The final regulations under Reg. Sec. 1.954-3(b) modify the proposed and temporary regulations in three ways:

- (1) Reg. Sec. 1.954-3T(b)(1)(ii)(c)(3)(iii) provided that if no branch independently satisfies a manufacturing test but the branches collectively satisfy a manufacturing test then the "tested manufacturing location" for purposes of applying the manufacturing branch rule is the location of manufacture, unless the "tested sales location" provides a "demonstrably greater" contribution.

The final regulations modify this section by removing the word "demonstrably" in order to clarify that the rule does not require an elevated standard of proof;



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- (2) Reg. Sec. 1.954-3T(b)(2)(ii)(a) provided for grouping of branches that do not have tax rate disparity with one another for purposes of determining whether a branch, treated as a separate corporation, has FBCSI (thereby allowing the activities of branches that do not have tax rate disparity with the branch to be considered in determining whether the branch satisfies the manufacturing exception).

The final regulations modify this section by adding the phrase "the activities of" in order to clarify that the rule applies only to group the activities, and not the income, of the branches; and

- (3) Reg. Sec. 1.954-3(b)(2)(ii) provided that income that is FBCSI as a result of Reg. Sec. 1.954-3(b)(1)(i) (the purchasing/selling branch rules) is not again classified as FBCSI as a result of Reg. Sec. 1.954-3(b)(1)(ii) (the manufacturing branch rules).

The final regulations remove this section. It is no longer needed due to the addition of Reg. Sec. 1.954-3(b)(1)(ii)(c)(1), which provides that only the manufacturing branch rules apply if one or more purchase or sales branches are used in addition to a manufacturing branch.

The final regulations also announce that the IRS and Treasury Department continue to study additional FBCSI issues. They 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, foreign base company sales income and foreign base company services income.

## *Effective date*

The regulations are effective when published in the Federal Register, which is anticipated to be December 19, 2011. The regulations apply to tax years of CFCs beginning after June 30, 2009, and for tax years of United States shareholders in which or with which such tax years of the CFCs end.

Taxpayers may choose to apply the final regulations retroactively with respect to open taxable years that began prior to July 1, 2009 if, and only if, the taxpayer and all members of its affiliated group apply the final regulations, in their entirety, to the earliest taxable year of each CFC that ends with or within an open taxable year of the taxpayer and all subsequent taxable years.

**[Click here to access the final regulations.](#)**

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