
Section 954.—Foreign Base Company Income.

26 CFR 1.954-3: Foreign base company sales income. (Also sections 7805, 301.7805-1.)

This ruling revokes Rev. Rul. 75-7, 1975-1 C.B. 244, and holds that the activities of a contract manufacturer cannot be attributed to a controlled foreign corporation for purposes of either section 954(d)(1) or section 954(d)(2) of the Code to determine whether the income of a controlled foreign corporation is foreign base company sales income. The ruling, however, provides 7805(b) relief for taxable years of a controlled foreign corporation beginning before December 8, 1997.

Rev. Rul. 97-48

In Rev. Rul. 75-7, 1975-1 C.B. 244, a controlled foreign corporation entered into an arm's length contract with an unrelated contract manufacturer located outside of its country of incorporation. Under the contract, the unrelated contract manufacturer agreed to perform manufacturing services for the controlled foreign corporation. Under the facts described in Rev. Rul. 75-7, the processing activities of the unrelated contract manufacturer were considered to be performed by the controlled foreign corporation outside its country of incorporation through a branch or similar establishment for purposes of section 954(d)(1) and (2) of the Internal Revenue Code.

In *Ashland Oil Co. v. Commissioner*, 95 T.C. 348 (1990), the Tax Court held that a manufacturing corporation unrelated to a controlled foreign corporation cannot be a branch or similar establishment of the controlled foreign corporation. See also, *Vetco, Inc. v. Commissioner*, 95 T.C. 579 (1990) (wholly-

owned subsidiary of a controlled foreign corporation cannot be a branch or similar establishment of the controlled foreign corporation).

The Service will follow the *Ashland* and *Vetco* opinions. The activities of a contract manufacturer cannot be attributed to a controlled foreign corporation for purposes of either section 954(d)(1) or section 954(d)(2) of the Code to determine whether the income of a controlled foreign corporation is foreign base company sales income. Accordingly, Rev. Rul. 75-7 is revoked.

Pursuant to the authority of section 7805(b), for taxable years of a controlled foreign corporation beginning before December 8, 1997, the principles of Rev. Rul. 75-7 may be relied upon to attribute the activities of a contract manufacturer to the controlled foreign corporation. A taxpayer that relies on Rev. Rul. 75-7 to attribute the activities of a contract manufacturer to a controlled foreign corporation for purposes of section 954(d)(1), however, must treat the contract manufacturing activities as being performed through a branch or similar establishment of the controlled foreign corporation for purposes of section 954(d)(2). The Service has never been of the view that Rev. Rul. 75-7 allows the activities of a contract manufacturer performed outside the controlled foreign corporation's country of incorporation to be attributed to the controlled foreign corporation without treating those activities as performed through a branch or similar establishment of the controlled foreign corporation.

With the revocation of Rev. Rul. 75-7, the Service's position on the treatment of contract manufacturing for purposes section 954(d) is harmonized with its position on the treatment of contract manufacturing for purposes of section 863(b) (see § 1.863-3(c) of the Income Tax Regulations (production activity limited to activity conducted directly by taxpayer)).

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 75-7, 1975-1 C.B. 244, is revoked effective December 8, 1997.

The principal author of this revenue ruling is Valerie Mark of the Office of the Associate Chief Counsel (International). For further information regarding this revenue ruling, contact Ms. Mark at (202) 622-3840 (not a toll-free call).
