No. _______

In the Supreme Court of the United States

WHIRLPOOL FINANCIAL CORPORATION
& CONSOLIDATED SUBSIDIARIES, ET AL.,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Numerous statutes are expressly conditioned on the promulgation of regulations that delineate when or how a particular statutory provision applies. In Section 954(d)(2) of the Internal Revenue Code, for example, Congress declared that certain income earned abroad by foreign corporations is subject to U.S. taxation; but Congress explicitly conditioned § 954(d)(2)'s execution on "regulations prescribed by the Secretary [of the Treasury]" delineating the income subject to taxation. 26 U.S.C. § 954(d)(2). Regulations implementing § 954(d)(2) have been in place, and relied upon by taxpayers in structuring their foreign operations, for over 50 years.

In this case, the Internal Revenue Service claimed that certain income earned abroad was taxable under those regulations. The taxpayer strongly disagreed. The parties, in turn, vigorously debated the application and validity of the regulations, and the Tax Court decided the case under the regulations. In the decision below, however, a divided panel of the Sixth Circuit held that the taxpayer's income was taxable under § 954(d)(2) without even consulting the regulations—even though, as the dissent below recognized, the income would *not* be taxable under the regulations. The question presented is:

Whether the divided Sixth Circuit properly held—in conflict with precedent of this Court and settled administrative-law principles—that a statute that is conditioned on regulations delineating its reach may be enforced without regard to those regulations?

PARTIES TO THE PROCEEDING

Petitioners Whirlpool Financial Corporation & Consolidated Subsidiaries and Whirlpool International Holdings S.à.r.l. (f/k/a Maytag Corporation) & Consolidated Subsidiaries were petitioners in the United States Tax Court and appellants in the court of appeals.

Respondent Commissioner of Internal Revenue was the respondent in the United States Tax Court and the appellee in the court of appeals.

RULE 29.6 STATEMENT

Pursuant to this Court's Rule 29.6, Petitioners Whirlpool Financial Corporation & Consolidated Subsidiaries and Whirlpool International Holdings S.à.r.l. (f/k/a Maytag Corporation) & Consolidated Subsidiaries respectfully state that they are wholly owned subsidiaries of Whirlpool Corporation. Whirlpool Corporation is a publicly traded corporation. No publicly held company owns more than 10% of the stock of Whirlpool Corporation.

RELATED PROCEEDINGS

The following proceedings are directly related to this petition:

Whirlpool Financial Corp. & Consolidated Subsidiaries v. Commissioner of Internal Revenue, No. 20-1899, United States Court of Appeals for the Sixth Circuit, opinion and judgment entered December 6, 2021 (19 F.4th 944), rehearing denied March 2, 2022 (2022 WL 807538).

Whirlpool International Holdings, S.a.r.l., f/k/a Maytag Corp. & Consolidated Subsidiaries v. Commissioner of Internal Revenue, No. 20-1900,

United States Court of Appeals for the Sixth Circuit, opinion and judgment entered December 6, 2021 (19 F.4th 944), rehearing denied March 2, 2022 (2022 WL 807538).

Whirlpool Financial Corp. & Consolidated Subsidiaries v. Commissioner of Internal Revenue, No. 13986-17, United States Tax Court, opinion entered May 5, 2020 (154 T.C. 142), decision entered June 9, 2020.

Whirlpool International Holdings, S.a.r.l., f/k/a Maytag Corp. & Consolidated Subsidiaries v. Commissioner of Internal Revenue, No. 13987-17, United States Tax Court, opinion entered May 5, 2020 (154 T.C. 142), decision entered June 9, 2020.

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PETITION FOR A WRIT OF CERTIORARI

Petitioners Whirlpool Financial Corporation & Consolidated Subsidiaries and Whirlpool International Holdings S.à.r.l. & Consolidated Subsidiaries (collectively, "Whirlpool") respectfully petition this Court for a writ of certiorari to review the judgment of the United States Court of Appeals for the Sixth Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App. 1a-40a) is reported at 19 F.4th 944. The opinion of the United States Tax Court (App. 41a-92a) is reported at 154 T.C. 142.

JURISDICTION

The court of appeals entered its opinion and judgment (App. 1a-40a) on December 6, 2021, and denied Whirlpool's timely petition for rehearing and rehearing en banc (App. 93a-94a) on March 2, 2022. On May 13, 2022, Justice Kavanaugh extended the time within which to file a petition for a writ of certiorari to and including June 30, 2022. This Court has jurisdiction under 28 U.S.C. § 1254(1).

STATUTORY AND REGULATORY PROVISIONS INVOLVED

Relevant statutory and regulatory provisions are reproduced in the appendix to this petition. App. 95a-108a. Citations are to the versions in effect for the 2009 tax year at issue, which have not changed in ways material to the question presented.

INTRODUCTION

This case presents an important and recurring question of administrative law—whether or in what circumstances a statute that is expressly conditioned on regulations to be promulgated by an agency may be enforced without regard to such regulations.

The divided Sixth Circuit below held that a tax statute explicitly conditioned on regulations to be promulgated by the Secretary of the Treasury delineating the income subject to taxation could be enforced without consulting the Secretary's regulations, even though the regulations bound the Internal Revenue Service ("IRS") and the IRS actually imposed tax based on the regulations. That decision directly contravenes this Court's precedents and settled administrative-law principles. It upsets the reliance interests of taxpayers who, for more than 50 years, have relied on the regulations in structuring their operations. And this issue is outcome-determinative because—as the dissent below concluded—the income at issue is *not* taxable under a proper reading of the regulations. App. 39a.

Section 954(d)(1) of the Internal Revenue Code designates certain foreign income earned by foreign corporations as "foreign base company sales income," or "FBCSI"—thereby subjecting the income to immediate U.S. taxation when U.S. tax would otherwise be deferred. But § 954(d)(2)—the neighboring provision—establishes a special rule for foreign branches. It provides that certain income earned by foreign branches "shall constitute [FBCSI]" "under regulations prescribed by the Secretary [of the Treasury]." 26 U.S.C. § 954(d)(2). The Secretary issued detailed regulations implementing § 954(d)(2)

more than 50 years ago, specifying what branch income qualifies as FBCSI, and companies like Whirlpool have relied on those regulations ever since.

For more than a century, this Court has recognized that structurally identical statutes—containing similar "under regulations" limitations—are not self-executing and cannot be enforced in the absence of, or without regard to, the regulations. *See Dunlap v. United States*, 173 U.S. 65, 76 (1899); *infra* at 17-20. When Congress enacts such statutes, the Court long ago explained, Congress "condition[s]" the statute on "regulations to be prescribed" within the parameters set by Congress. 173 U.S. at 76. The IRS understood this when it relied on the regulations to impose the tax at issue. And in the litigation that ensued, the parties, the Tax Court, and the dissent below all focused on the application and validity of the regulations effectuating § 954(d)(2).

But "[o]n appeal, something very strange happened. . . . [T]he Sixth Circuit [majority] ignored the regulations." Andy Grewal, *The Sixth Circuit Conjures Phantom Regulations*, Yale J. on Regul. Notice & Comment (Feb. 21, 2022).[1] Instead of resolving the parties' disputes about the regulations, the majority held, for the first time in the more-than-50-year history of § 954(d)(2), that income was FBCSI under § 954(d)(2) alone. It declined to consider the regulations—even though, as the dissent recognized, Whirlpool would *win* under the regulations on which Congress explicitly conditioned § 954(d)(2).

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[1] Available at https://www.yalejreg.com/nc/the-sixth-circuit-conjures-phantom-regulations/.

The Sixth Circuit's divided decision conflicts with *Dunlap* and like decisions of this Court, and flouts Congress's intent. The "under regulations" language in § 954(d)(2) unambiguously "demonstrates the intent of Congress to leave the entire matter to the Treasury Department to ascertain what would be needed in order to carry the section into effect." *Dunlap*, 173 U.S. at 76. Ignoring the regulations rewrites the statute by excising the "under regulations" limitation and vitiates the role that Congress assigned to an expert agency to delineate what income is subject to immediate taxation.

Disregarding the regulations is especially inappropriate when, as here, the regulations are intended to *limit* the statute's reach to particular circumstances. Under bedrock principles of administrative law, valid regulations have the force of law; regulated parties, agencies, and courts alike are bound by them. And the public and businesses must rely on regulations in shaping their affairs. The Sixth Circuit's reasoning here amounts to changing the rules after the fact, depriving Whirlpool of fair notice and eviscerating the reasonable reliance interests it had formed in the regulations.

The decision below will have enormous practical consequences as well. U.S. companies, including Whirlpool, have relied on the regulations at issue in conducting their foreign operations for more than 50 years. As numerous commentators and amici curiae have made clear, the decision will directly affect many other taxpayers and produce billions of dollars of unjustified tax liability. Moreover, the Sixth Circuit's decision in this case creates two different tax regimes across the nation—in the Sixth Circuit, whether branch income is FBCSI is determined based only on

the statute; elsewhere, it is determined based on the statute and regulations called for by Congress.

But that is not all. Hundreds of laws—both tax and non-tax alike—contain similar "under regulations" limitations. The decision below creates uncertainty about all of those laws. And more broadly, it undermines regulated parties' ability to rely on regulations that are supposed to bind the government and have the force and effect of law. This Court has seen its share of regulatory abuses, where agencies exceed Congress's grant of rulemaking power. But it has not questioned that Congress may delegate rulemaking power to agencies. And the Court has repeatedly stressed that courts must give effect to the unambiguous intent of Congress. Ignoring that express intent by rewriting a statute that is conditioned on the promulgation of regulations is no less an affront to the separation of powers than an agency's abuse of the power granted by Congress.

The petition should be granted.

STATEMENT OF THE CASE

A. Statutory And Regulatory Background

1. The United States has traditionally not taxed income earned abroad by foreign corporations until the income is repatriated to the U.S. *See* Boris I. Bittker & James S. Eustice, *Federal Income Taxation of Corporations and Shareholders* ¶ 15.20 (Westlaw online ed. Nov. 2020 update). That rule generally permits a U.S. corporation to defer U.S. tax on foreign income earned by foreign subsidiaries until the income is distributed to the U.S. parent. *See id.* This case concerns an exception to that general rule,

codified in § 954(d) of the Internal Revenue Code, for "foreign base company sales income," or "FBCSI."

The FBCSI exception targets income earned from certain sales of goods involving related entities. Congress found that U.S. taxpayers were able to use related-party sales to artificially separate sales income from manufacturing income and shift the sales income to low-tax jurisdictions. *See* S. Rep. No. 87-1881, at 84 (1962); *see also* Staff of J. Comm. on Internal Revenue Tax'n, *Tax Effects of Conducting Foreign Business Through Foreign Corporations*, No. JCS-5-61, at 12-15 (July 21, 1961). In § 954(d)(1), Congress defined FBCSI to end U.S. tax deferral on the artificially separated sales income. *See, e.g.*, 26 U.S.C. § 954(d)(1); Bittker & Eustice, *supra*, ¶ 15.62[2][b]. But Congress did not end deferral on sales income that has *not* been artificially separated from manufacturing income—such as income that a foreign subsidiary earns from selling goods that it manufactures itself. *See* S. Rep. No. 87-1881, at 84.

This scheme—which effectively establishes a "manufacturing exception" from § 954(d)(1)—follows from both the text of § 954(d)(1) and a regulation promulgated contemporaneously with the FBCSI exception, over 50 years ago. That regulation states that "[FBCSI] does *not* include income of a controlled foreign corporation derived in connection with the sale of personal property manufactured, produced, or constructed by such corporation." 29 Fed. Reg. 6385, 6394 (May 15, 1964) (codified at 26 C.F.R. § 1.954-3(a)(4)) (emphasis added); *see also infra* at 8.

To illustrate, suppose that U.S. Co.'s Singaporean subsidiary, Singapore Sub, manufactures computers in Singapore for $1,000. If Singapore Sub sells the computers for use in Europe for $1,100, it earns $100.

That income is *not* FBCSI—it comes from selling computers that Singapore Sub manufactures—and so is not taxed by the U.S. until it is distributed to U.S. Co. But if Singapore Sub instead sells the computers to U.S. Co.'s Cayman Islands subsidiary, Cayman Sub, for $1,075, and Cayman Sub turns around and resells the same computers for use in Europe for $1,100 (without manufacturing anything), the $25 of income that Cayman Sub earns from reselling the computers has been separated from the manufacturing activities and *is* FBCSI. There, Cayman Sub's *sales* income—but not Singapore Sub's manufacturing income—is taxable by the U.S. as FBCSI in the year it is earned.

2. Congress also recognized a special problem posed by foreign *branches*. *See* 26 U.S.C. § 954(d)(2). A branch is distinct from a subsidiary. It consists of a corporation's direct operations in a foreign country, and is not a related person for purposes of the FBCSI exception. *See id.* § 954(d)(3); App. 68a. As a result, transactions between a corporation's home office and its foreign branch cannot generate FBCSI under § 954(d)(1). Extending the example above, if Singapore Sub sells the computers it manufactures to its own Cayman *branch* (rather than a related Cayman *subsidiary*), which resells them for use in Europe, there is no FBCSI under § 954(d)(1). Congress understood that foreign tax laws may nonetheless treat such a branch like a related entity and could allow results similar to those that animated the FBCSI exception. *See* S. Rep. No. 87-1881, at 84.

To address this issue, Congress included § 954(d)(2) when it enacted the FBCSI exception in 1962. Section 954(d)(2) states:

> **Certain branch income.**—For purposes of determining [FBCSI] in situations in which the carrying on of activities by a controlled foreign corporation through a branch or similar establishment outside the country of incorporation of the controlled foreign corporation has substantially the same effect as if such branch or similar establishment were a wholly owned subsidiary corporation deriving such income, *under regulations prescribed by the Secretary the income attributable to the carrying on of such activities of such branch or similar establishment shall be treated as income derived by a wholly owned subsidiary of the controlled foreign corporation and shall constitute [FBCSI] of the controlled foreign corporation.*

26 U.S.C. § 954(d)(2) (emphasis added). As the italicized text makes clear, Congress expressly cabined and conditioned the branch income subject to the FBCSI exception based on regulations to be prescribed by the Secretary of the Treasury.

3. Shortly after the FBCSI exception was enacted, the Secretary promulgated regulations implementing § 954(d), just as Congress directed. *See* 29 Fed. Reg. at 6385-6402; 27 Fed. Reg. 12759 (Dec. 27, 1962) (notice of proposed rulemaking). Those regulations, which have been in place for over 50 years, contain detailed rules specifying how the FBCSI exception applies in situations involving a branch, which, in turn, delineate the income that triggers § 954(d)(2). *See generally* 26 C.F.R. § 1.954-3(b).

Through the application of specific criteria, *see id.* § 1.954-3(b)(1)(i)(*b*), (ii)(*b*), the regulations aim to capture arrangements between a foreign subsidiary's branch and its home office (called the "remainder" in the regulations) that produce "substantially the same tax effect as if the branch . . . were a wholly owned subsidiary corporation," *id.* § 1.954-3(b)(1)(i)(*a*), (ii)(*a*). If such criteria are met, the branch and the remainder are "treated as separate corporations," and the usual FBCSI rules are applied to the arrangement as modified to determine whether there is FBCSI. *Id.*

Under the regulations, there are two situations in which income qualifies as FBCSI. *First*, if the remainder manufactures products, which are sold by or through the branch (a sales branch), the branch's sales income is deemed to be FBCSI. *See id.* § 1.954-3 (b)(2)(ii)(*b*), (4) Example 1. This rule would make the income of the hypothetical Cayman branch discussed above FBCSI. *See supra* at 7. *Second*, if the branch manufactures products (a manufacturing branch), which are sold by or through the remainder, the remainder's sales income is deemed to be FBCSI. *See* 26 C.F.R. § 1.954-3(b)(2)(ii)(*c*), (4) Example 2.

The regulations also make clear that income is *not* FBCSI "if the income would not be so considered if it were derived by a separate controlled foreign corporation under like circumstances." *Id.* § 1.954-3(b)(2)(ii)(*e*). If, for example, a branch sells goods that it manufactures, it is entitled to the manufacturing exception—just as it would be if it were a separate corporation—and the manufacturing income in that situation is not FBCSI. *See id.*; *see also id.* § 1.954-3(b)(4) Example 2 ("Branch B, treated as a separate corporation, derives no [FBCSI] since it produces the product which is sold.").

B. Factual Background

1. This case arises out of Whirlpool's participation in Mexico's "maquiladora" program, which is designed to create jobs by incentivizing companies to manufacture goods in Mexico for export to other countries. App. 7a-8a. This program requires two entities, a foreign principal organized outside of Mexico and a Mexican maquiladora company. The foreign principal is required to supply the raw materials and manufacturing equipment in Mexico, hold title to the work-in-process and finished inventory in Mexico, and export the finished goods from Mexico to other countries. *Id.* The maquiladora company is required to provide the manufacturing labor. *Id.*; *see* CA6 App. 420. When the requirements of the maquiladora program are met, among other benefits, the Mexican government reduces the tax rate imposed on the maquiladora company's income and fully exempts the foreign principal's Mexican income from tax. *See infra* at 11-12 & n.2.

Whirlpool subsidiaries have long manufactured appliances in Mexico for sale internationally. In 2007, to qualify for Mexico's maquiladora program, Whirlpool reorganized some of its Mexican operations into two subsidiaries. App. 6a, 8a. Whirlpool Overseas Manufacturing (or "Lux") was the foreign principal. *Id.* Lux's home office in Luxembourg had a single part-time employee and engaged in limited administrative activities. *Id.* at 6a, 9a. But Lux also had a Mexican branch, with over 3,000 employees, which served as a contract manufacturer for other Whirlpool subsidiaries. Pursuant to contracts with these subsidiaries, the Mexican branch manufactured washing machines and refrigerators and was

compensated on a cost-plus basis. *See* CA6 App. 1348-52. The initial contract price was set at cost-plus-6%, but it could be adjusted to ensure that Lux earned only an "arm['s] length return" for its manufacturing services. *Id.* at 1352; *accord* App. 7a.

To manufacture the appliances, Lux invested hundreds of millions of dollars to acquire raw materials, inventory, and equipment, which were located in Mexico and part of its Mexican branch. App. 6a-7a; *see* CA6 App. 873. Lux also owned Whirlpool Internacional (or "WIN"), a maquiladora company that supplied the labor to assemble the appliances through contractual arrangements with other Whirlpool subsidiaries—an "extremely common" practice in Mexico. CA6 App. 425; *see* App. 6a. Because WIN was disregarded for U.S. tax purposes (as if it did not separately exist), WIN was treated as part of Lux's Mexican branch. App. 10a; *id.* at 45a-46a; *see* 26 C.F.R. § 301.7701-2(a).

2. This reorganization reduced Whirlpool's Mexican taxes through the incentives provided by Mexico's maquiladora program. All of Lux's Mexican branch income—including Lux's income from its direct investments in raw materials, inventory, and equipment, as well as its income from WIN's labor—was earned in Mexico and was Mexico's to tax. *See* CA6 App. 421. For that reason, Luxembourg (Lux's home country) did not tax any of that income. *See* App. 9a; CA6 App. 1187-88. As long as Lux qualified for the maquiladora program, Mexico taxed only the income attributable to WIN's labor, and at a reduced rate. Mexico "chose[] not to tax" Lux's other income—*i.e.*, income from its manufacturing investments—"as

a further incentive under the [m]aquiladora [p]rogram." CA6 App. 421; *see* App. 8a.[2]

But the reorganization did not change where Whirlpool's Mexican income was earned or the character of that income. Both before and after the reorganization, Whirlpool's Mexican operations generated manufacturing income in Mexico. As explained above, the reorganization merely resulted in lower Mexican taxes on that Mexican income. Nor did the reorganization shift income out of the U.S. or otherwise shelter income from U.S. taxes. All the income will be taxed once it actually enters the U.S. In fact, due to the reorganization, the U.S. will ultimately collect more taxes, because reducing Mexican taxes also reduces the foreign tax credits Whirlpool can take against its U.S. taxes when the income is repatriated. *See* 26 U.S.C. § 901.

3. In 2009, Lux's Mexican branch owned over $250 million in manufacturing assets, manufactured hundreds of thousands of washing machines and refrigerators, received over $800 million under its manufacturing contracts, paid over $700 million in manufacturing expenses, and ultimately earned about $45 million. *See* App. 8a; *id.* at 48a-49a, 51a n.3; CA6 App. 875-76, 1445-46. Lux also earned about

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[2] This result flowed from the Luxembourg-Mexico tax treaty. Under the treaty, each country may tax the income of a "permanent establishment" within its borders. App. 8a-9a. The Luxembourgian tax authority ruled that Lux's manufacturing income was attributable to a Mexican permanent establishment, so Luxembourg did not tax that income. *See* CA6 App. 1187-88. And if Lux qualified for the maquiladora program, Mexico deemed Lux not to have a permanent establishment in Mexico (even though it had a Mexican permanent establishment) and did not tax the income either. CA6 App. 421; *see* App. 8a-10a.

$5 million in interest and other income attributable to its home office in Luxembourg. *See* App. 51a n.3.

C. Procedural History

1. In 2017, the IRS issued Whirlpool notices of deficiency asserting that the $45 million that Lux earned in Mexico in 2009 for its manufacturing activities was FBCSI. App. 10a; *id.* at 51a-52a. Whirlpool petitioned the Tax Court for redetermination. As relevant here, the parties cross-moved for summary judgment on whether the income was FBCSI under the regulations implementing § 954(d)(2). *Id.* at 10a-11a.[3] The parties agreed that Lux had a manufacturing branch in Mexico, but disagreed about whether income from the branch arrangement was FBCSI under the IRS's regulations.

The IRS analogized the arrangement to one in which the remainder—*i.e.*, Lux's home office in Luxembourg, which had no significant operations, *see supra* at 10—sells goods for the branch. *See* CA6 App. 2555-57, 2565-67. The IRS argued that the income at issue was from the remainder's sale of appliances and therefore qualified as FBCSI under the regulations. *See id.* at 2565-67; *supra* at 6-7, 9.

Whirlpool, by contrast, observed that essentially all of Lux's activities occurred in its Mexican branch and focused on *manufacturing* appliances—*i.e.*, turning Lux's raw materials into finished goods under Lux's manufacturing contracts. *See* CA6 App. 386.

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[3] Whirlpool also filed a motion for summary judgment arguing that the income at issue was not FBCSI under § 954(d)(1). App. 43a. The Tax Court denied that motion, holding that factual issues precluded summary judgment, for reasons that are not relevant here. *See id.* at 57a-67a.

Whirlpool argued that the remainder conducted no selling activity that could produce FBCSI under the regulations; rather, the only potential "sale" was by the Mexican branch, of goods that the branch manufactured itself in Mexico—a transaction that the manufacturing exception makes clear cannot produce FBCSI. *See id.* at 380-82; *supra* at 6, 9. Alternatively, Whirlpool argued that there could be no FBCSI because the regulations on which the IRS relied were invalid: The regulations deem income earned *outside* the branch—*i.e.*, the remainder's sales income—to be FBCSI, whereas § 954(d)(2) allows only *branch* income to be treated as FBCSI. *See id.* at 387-92.

The IRS never argued that tax could be imposed regardless of the regulations.

2. The Tax Court granted summary judgment to the IRS. In doing so, the court examined both § 954(d)(2) and the implementing regulations, but it decided the case based on the regulations alone.

After discussing the text of § 954(d)(2), the Tax Court recognized that this was just the beginning, and not the end, of the case. As the court explained, Congress had "directed" the Secretary of the Treasury to prescribe regulations implementing § 954(d)(2), which supply "refinements" to the statute. App. 73a. The court then discussed the application and validity of the regulations at length, considering the parties' arguments about the regulations. *Id.* at 73a-91a Ultimately, the court held that the $45 million of income at issue was FBCSI under the regulations and that those regulations were valid. *See id.*

3. In a divided 2-1 opinion, the Sixth Circuit affirmed—but on an entirely different basis of its own.

The majority confined its analysis to the statute alone. Drawing on a speech by President Kennedy—whose tax-reform proposal was rejected by Congress, *see* S. Rep. No. 87-1881, at 79—and other statements issued over a year before the enactment of § 954(d)(2), the majority concluded that the statute captures situations in which a controlled foreign corporation's "'carrying on of activities' through a foreign branch had a substantial tax-deferral effect." App. 17a. The majority determined that Lux's branch arrangement presented such a situation. *Id.* And the majority held that the statute "expressly prescribes the consequences that follow": "[S]ales income 'attributable to' the 'carrying on' of activities through Lux's Mexican branch . . . 'shall constitute [FBCSI].'" *Id.* at 17a-18a (quoting 26 U.S.C. § 954(d)(2)).

In so holding, the majority declined to consider the application or validity of the § 954(d)(2) regulations—on which the parties had focused. The majority acknowledged that the statute explicitly states that consequences in § 954(d)(2) "'shall' follow" "'under regulations prescribed by the Secretary.'" *Id.* at 18a (quoting 26 U.S.C. § 954(d)(2)). But it reasoned that this provision allows the Secretary only to "implement the statute's commands, not vary from them," and thus disavowed any need to consider the regulations. *Id.* The majority did not explain how the IRS could collect the tax based on a theory different from the one on which it relied in imposing the tax—that the income was FBCSI under the regulations.

4. Judge Nalbandian dissented. He disagreed that the case could be resolved without considering the regulations. As he explained, "[r]ead naturally," § 954(d)(2) "says that 'income attributable' to the branch's activities 'shall constitute' FBCSI 'under

regulations prescribed by the Secretary.'" App. 27a (quoting 26 U.S.C. § 954(d)(2)). And "[t]his means," he continued, "Congress gave Treasury a role in defining when branch transactions generate FBCSI." *Id.* As he put it, "[w]e can easily read 'shall constitute' in context as giving Treasury a role in defining when branch transactions generate FBCSI." *Id.* at 30a.

As Judge Nalbandian further explained, the regulations serve a critical limiting function. "All [§ 954(d)(2)] says is 'income attributable' to the branch's activities *could* be FBCSI"; "nothing in (d)(2) cabins the type of income" captured by the statute. *Id.* at 28a (emphasis added). As a result, he continued, "[i]f 'shall constitute' is enough by itself to label income FBCSI, then all sorts of income would be open to designation as FBCSI, *even if no sales transactions occurred*. (An odd result, given that § 954(d) is all about *sales* income.)" *Id.* Judge Nalbandian thus concluded that the regulations that Congress explicitly called for were necessary to ensure that § 954(d)(2) does not capture manufacturing, interest, or other non-sales income. *See id.* at 27a-30a.

Turning to the regulations, Judge Nalbandian observed that Lux "[t]ransform[ed] sheets of metal into functioning household appliances"—an activity that qualifies for the regulatory manufacturing exception. *Id.* at 36a-37a. Accordingly, he concluded that "Whirlpool should prevail under the applicable regulations as written." *Id.* at 39a n.6.

5. The Sixth Circuit denied rehearing, with Judge Nalbandian dissenting. App. 93a-94a.

REASONS FOR GRANTING THE WRIT

The Sixth Circuit's split decision finding a tax deficiency without considering the regulations on

which Congress conditioned the statute creating the tax, and on which the IRS relied in imposing the tax, conflicts with this Court's longstanding precedent and settled principles of administrative law. The decision creates separate taxation regimes across the country—one in which only the statute applies, and another in which the statute and regulations apply—depending purely on geographic happenstance. It profoundly disrupts settled reliance interests based on regulations that have been in place—and relied upon by taxpayers like Whirlpool in structuring their operations—for more than 50 years. And, if allowed to stand, the decision will cast doubt on whether taxpayers and other regulated parties can rely on tax *and* non-tax regulations that are supposed to have the force and effect of law. Certiorari is warranted.

A. The Sixth Circuit's Decision Conflicts With This Court's Precedent

1. The decision below conflicts with this Court's longstanding precedent on whether a statute conditioned on the promulgation of regulations may be enforced without regard to such regulations.

Dunlap v. United States, for example, involved a statute that allowed manufacturers "to use alcohol in the arts, or in any medicinal or other like compound . . . *under regulations to be prescribed by the Secretary of the Treasury*" and provided that manufacturers "shall be entitled" to a refund of stamp taxes paid on such alcohol. 173 U.S. 65, 70 (1899) (emphasis added) (citation omitted). The Secretary never issued the regulations called for by Congress, however, and a manufacturer sought a stamp-tax refund under the statute alone. *Id.* at 71, 74. The Court held that the statute could not be enforced in the absence of

regulations. "Congress had left it to the Secretary to determine whether any [regulations] which he could prescribe and enforce would adequately protect the revenue and the manufacturers." *Id.* at 71. Thus, the refund right "was conditioned on use in compliance with regulations to be prescribed, in the absence of which the right could not vest." *Id.* at 76.

Dunlap also recognized that a court may not impose its own view of what a statute requires when the statute is to be effectuated "under regulations" prescribed by an agency. As the Court admonished, "courts cannot perform executive duties, nor treat them as performed when they have been neglected." *Id.* at 72 (quoting *United States v. McLean*, 95 U.S. 750, 753 (1878)). That is, while courts may "requir[e] the prompt issuance of regulations," they may not issue "a judicial decree setting forth the content of those regulations." *Norton v. Southern Utah Wilderness All.*, 542 U.S. 55, 65 (2004).

The Court's longstanding precedents also underscore the *effect* of regulations issued pursuant to a statute to be effectuated "under regulations." In *Campbell v. United States*, for example, a statute authorized a "drawback" of duties paid on imported materials when incorporated into manufactured goods, "to be ascertained under such regulations as shall be prescribed by the Secretary of the Treasury." 107 U.S. 407, 407 (1883). The Secretary issued regulations implementing the statute, and a manufacturer who sought a drawback of import duties complied with them in full. *Id.* at 409. Despite the manufacturer's compliance with the regulations, the Secretary and his agents "wholly refused" to take any action on the manufacturer's drawback request. *Id.* The Court held that this was improper. As the

Court explained, the right to a drawback was "founded on a law of Congress," conditioned on the issuance of valid regulations; compliance with the regulations "fixed" the manufacturer's legal right to a drawback; and the Secretary's intransigence could not "defeat" that right. *Id.* at 410-11.

The statutes at issue in these cases are just a few examples of statutes that are "not self-executing." *California Bankers Ass'n v. Shultz*, 416 U.S. 21, 64 (1974). *California Bankers* concerned a statute that imposed penalties for violations of bank-reporting regulations prescribed by the Secretary of the Treasury. *See id.* at 35-41. As the Court explained, "were the Secretary to take no action whatever under his authority there would be no possibility of criminal or civil sanctions." *Id.* at 64; *see also, e.g.*, *United Dominion Indus., Inc. v. United States*, 532 U.S. 822, 826 (2001) (statute permitted related entities "to file a single consolidated return" and left "it to the Secretary of the Treasury to work out the details by promulgating regulations governing such returns"); *Good Samaritan Hosp. v. Shalala*, 508 U.S. 402, 405 & n.1 (1993) (statute required agency to reimburse reasonable costs under "regulations establishing the method or methods to be used" (citation omitted)); *Commissioner v. Portland Cement Co. of Utah*, 450 U.S. 156, 159 (1981) (statute authorized depletion allowance for mineral investments "in all cases to be made under regulations prescribed by the Secretary" (citation omitted)).

The lesson of *Dunlap* and these other cases is that Congress's directive that a statute be implemented through regulations must be given effect—just like any other textual command—and that in determining whether the statute may be enforced in a particular

situation, a court must therefore apply the regulations called for by Congress (unless shown to be invalid). *See, e.g.*, *Good Samaritan Hosp.*, 508 U.S. at 418-19 ("[W]here, as here, the statute expressly entrusts the Secretary with the responsibility for implementing a provision by regulation, our review is limited to determining whether the regulations promulgated exceeded the Secretary's statutory authority and whether they are arbitrary and capricious." (citation omitted)); *Portland Cement*, 450 U.S. at 165 (finding "the[] regulations dispositive"). This conclusion follows naturally from the cardinal rule that, under our separation of powers, courts must give effect to the unambiguous intent of Congress.

2. The Sixth Circuit's decision in this case directly conflicts with *Dunlap* and these other cases.

a. As Judge Nalbandian explained, by explicitly embedding the "under regulations prescribed by the Secretary" language in § 954(d)(2), Congress gave the Secretary of the Treasury a role in defining the circumstances in which branch income would be deemed FBCSI. App. 27a. To be sure, as the court below recognized, § 954(d)(2) sets forth two threshold conditions: a controlled foreign corporation must operate through a foreign branch, and the use of the branch must "ha[ve] substantially the same" tax effect as if the branch were a subsidiary. 26 U.S.C. § 954(d)(2); *see* App. 12a-17a. And the statute states the consequences of triggering § 954(d)(2): such branch income "shall be treated as income derived by" a subsidiary and "shall constitute [FBCSI]." 26 U.S.C. § 954(d)(2); *see* App. 17a-18a.

But the majority skipped over the rest of the statute. As Judge Nalbandian explained, "'under regulations prescribed by the Secretary'" is *also* part

of the "'statutory command,'" and that prescription "modifies" the statutory consequences. App. 27a (quoting 26 U.S.C. § 954(d)(2)). Under the express terms of the statute, the only way that income can constitute FBCSI is by qualifying as such "under regulations prescribed by the Secretary." Congress thus gave the Secretary a role in delineating what income constitutes FBCSI. *Cf. United Dominion*, 532 U.S. at 838 (agreeing that statute expressly directing the Secretary of the Treasury to prescribe regulations on consolidated returns "vest[ed] ample authority in the Treasury to adopt consolidated return regulations to effect a binding resolution of the question presented" (citation omitted)). That is, § 954(d)(2) demarcates the outer bounds of what branch income can constitute FBCSI and directs the Secretary to clarify and narrow the statute's reach.

Comparing § 954(d)(2) with § 954(d)(1) confirms that the regulations serve as an express limitation on what income qualifies as FBCSI under § 954(d)(2). Section 954(d)(1) was enacted at the same time as § 954(d)(2), is very detailed, and yet contains no "under regulations" condition. Unlike § 954(d)(2), § 954(d)(1) *is* a self-executing statute. In fact, the Internal Revenue Code is replete with other ways Congress could have written § 954(d)(2) if it had not intended to condition the statute on the Secretary's regulations. *See, e.g.*, 26 U.S.C. § 280G(d)(5) ("*Except as otherwise provided in regulations* all members of the same affiliated group . . . shall be treated as 1 corporation . . . ." (emphasis added)); *id.* § 909(e) ("The Secretary *may issue* such regulations or other guidance as is necessary or appropriate to carry out the purposes of this section . . . ." (emphasis added)).

Nor is it surprising that Congress would impose such an "under regulations" condition. Administering § 954(d)(2) raises many issues that Congress directed the Secretary to resolve through regulations—and that the Secretary did resolve in regulations promulgated over 50 years ago. Chief among them is what branch income "shall constitute [FBCSI]." As Judge Nalbandian observed, § 954(d)(2) could allow *any* "income attributable" to a branch to be treated as FBCSI, even manufacturing or interest income that would not be FBCSI under § 954(d)(1). *See* App. 28a ("If 'shall constitute' is enough by itself to label income FBCSI, then all sorts of income would be open to designation as FBCSI, *even if no sales transaction occurred*."); *supra* at 16. So Congress directed the Secretary to promulgate regulations to ensure that § 954(d)(2) is given its proper scope.

That express intent must be given effect. As Professor Grewal and other commentators have observed, "Congress acts deliberately when it decides that a statutory rule will apply 'under regulations.' Through that language, Congress decides that agencies, as experts, should examine tradeoffs and determine whether and how a potential rule should apply." Grewal, *supra*; *see also, e.g.*, Gary B. Wilcox, *The Sixth Circuit's* Ultra Vires *Opinion in* Whirlpool—*What Now?*, Int'l Tax J., Mar.-Apr. 2022, at 47, 49 ("[T]he express delegation in Code Sec. 954(d)(2) is a firm indication that Congress wanted these matters determined by persons with the appropriate expertise.");[4] Mindy Herzfeld, *The Sixth Circuit Knows Subpart F Income When It Sees It—Or*

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[4] Available at https://www.mayerbrown.com/-/media/files/perspectives-events/publications/2022/04/itj_4802_wilcox.pdf.

Does It?, 174 Tax Notes Fed. 316, 320 (Jan. 17, 2022) (the regulations "prescribed by statute are a necessary part of interpreting and implementing the statute"). As Judge Nalbandian explained here, given that § 954(d)(2) "addresses highly complicated matters," "it's easy to see why . . . Congress would want expanded immediate taxation to arise only after the Treasury followed the notice-and-comment-process." Grewal, *supra*. If income is not FBCSI under the § 954(d)(2) regulations (as Whirlpool argued and Judge Nalbandian found, App. 39a n.6), or if those regulations are invalid (as Whirlpool argued), then the income cannot be FBCSI under § 954(d)(2).

b. The centrality of the regulations to § 954(d)(2) is well established. The IRS advised taxpayers decades ago that § 954(d)(2) "gives the Secretary of the Treasury the authority to prescribe regulations to determine when the income attributable to [branch activities] shall constitute [FBCSI]." IRS Tech. Adv. Mem. 85-09004 (Nov. 23, 1984), 1984 WL 269913.

The IRS reiterated the same position in this case. In its motion for summary judgment, the IRS espoused Judge Nalbandian's view that § 954(d)(2) is broadly written and can capture manufacturing and other non-sales income of a branch. *See* CA6 App. 2584. The IRS argued that § 954(d)(2) "delegates authority to the Secretary of the Treasury" to issue regulations "narrowing the scope of section 954(d)(2) to provide that income of a branch that manufactures will not be treated as FBCSI (so that, in this instance, only sales income of the remainder of the [controlled foreign corporation] will be FBCSI)." *Id.* at 2584-85. In cases involving structurally identical statutes, the IRS has likewise relied entirely on the regulations in

imposing tax liability. *See, e.g.*, *SIH Partners LLLP v. Commissioner*, 150 T.C. 28, 37 (2018) (no dispute "that section 956(d) is not self-executing" or that liability "can be determined only by reference to regulations"), *aff'd*, 923 F.3d 296 (3d Cir. 2019), *cert. denied*, 140 S. Ct. 854 (2020).

Before the decision below, no one—least of all the IRS—had ever suggested that § 954(d)(2) could be enforced without regard to the IRS's regulations. Nor could the IRS disavow its decades-old regulations even if it wanted to; agencies, including the IRS, are *bound* by their regulations. *See infra* at 26-29. The Sixth Circuit's decision to rely solely on the statute—and disregard the regulations—in deciding this case was entirely unprompted. *See* Grewal, *supra* ("On appeal, something very strange happened. . . . [T]he Sixth Circuit ignored the regulations.").

c. The Sixth Circuit's approach contravenes the separation of powers. The majority seemed to believe that any time § 954(d)(2)'s threshold preconditions are met, branch income is FBCSI—and if the regulations provided otherwise, they would "vary from" rather than "implement the statute's commands." App. 18a. But, as explained above, § 954(d)(2) is not self-executing; Congress expressly conditioned its application on regulations. The phrase "under regulations prescribed by the Secretary" thus supplies a crucial limitation on the statute, directing the Secretary to make nuanced judgments that have the effect of exempting some income from the statute's reach. *See supra* at 20-23. As long as the regulations clarify and narrow the application of the statute, they plainly "implement the statute's commands." App. 18a. And a court is bound by those commands just like any other.

In some cases, courts may be appropriately wary of agencies overstepping an *implied* delegation of authority. *E.g.*, *Utility Air Regul. Grp. v. Environmental Prot. Agency*, 573 U.S. 302, 321 (2014). But here, Congress's delegation could not be clearer. In fact, it is hard to see what purpose the "under regulations" condition could serve if it does not authorize the Secretary to make judgments that clarify and narrow the scope of § 954(d)(2)'s branch rule. The Sixth Circuit effectively rewrote the statute, rendering the "under regulations" condition superfluous and contravening *Dunlap* and the other cases cited above, as well as "a cardinal principle of statutory construction." *Williams v. Taylor*, 529 U.S. 362, 404 (2000). *See* Grewal, *supra* (The Sixth Circuit's "nominally textual approach applies some statutory words and ignores others ('under regulations'). The Sixth Circuit should have given effect to all words found in Section 954(d)(2) . . . .").

The Sixth Circuit appeared to believe that § 954(d)(2) gives the Secretary too much "discretion" and "a power to do much more than 'fill up the details'" of the statute. App. 18a (quoting *Wayman v. Southard*, 23 U.S. (10 Wheat.) 1, 43 (1825)). But any discretion must be exercised within statutory parameters, and the regulations *do* "fill up the details" as long as they narrow § 954(d)(2)'s reach as Congress intended. In any event, if a statutory delegation of authority is too broad, the remedy is to invalidate the statute. Here, that would mean striking down § 954(d)(2)—a result that itself would bar the IRS from imposing tax under that statute. Instead, the court below rewrote the statute (by excising its "under regulations" condition), ignored the regulations, and imposed the tax anyway.

This Court recognized long ago that courts must give effect to Congress's deliberate act of conditioning the statute on regulations delineating its application. *See Dunlap*, 173 U.S. at 71-72. And while administrative law has evolved since then, the fundamental requirement that courts must give effect to the plainly expressed intent of Congress has remained fixed. The Sixth Circuit's decision contravenes this settled precedent. And this clear conflict alone warrants the Court's review.

B. The Sixth Circuit's Decision Also Contravenes Fundamental Principles Of Administrative Law

The Sixth Circuit's decision to resolve this case on a ground that the IRS had not advanced below—or, indeed, ever before—also is impossible to reconcile with bedrock principles of administrative law.

1. It is well-settled that regulations, including those that clarify or narrow the scope of statutory liability, bind the agency, unless they are found to be invalid by a court or are properly withdrawn. *See, e.g.*, *United States v. Caceres*, 440 U.S. 741, 751 n.14 (1979); *United States ex rel. Accardi v. Shaughnessy*, 347 U.S. 260, 266-67 (1954); *Columbia Broad. Sys. v. United States*, 316 U.S. 407, 420-21 (1942). Likewise, when an agency decides a matter based on a particular regulation, a reviewing court must review the matter on the same basis—not on some other basis that the agency might be able to give. *See, e.g.*, *Securities & Exch. Comm'n v. Chenery Corp.*, 318 U.S. 80, 87 (1943) ("The grounds upon which an administrative order must be judged are those upon which the record discloses that its action was based.").

Consider, for example, a regulation that provides a "safe harbor" to statutory liability. *See, e.g.*, *Sec. & Exch. Comm'n v. GenAudio Inc.*, 32 F.4th 902, 942-43 (10th Cir. 2022) (safe harbor for certain unregistered sales of securities). Even if the statute itself did not set forth the safe harbor, a regulated party may raise the safe harbor as a defense. The agency, being bound by its own regulation, must decide whether the regulated party is entitled to the safe harbor. And a reviewing court must review *that* agency decision—*i.e.*, whether the regulatory safe harbor applies. If a court could simply skip the sometimes complicated question whether the regulation applies and find that the regulated party is liable under the statute itself, the regulation would provide no safe harbor at all.

These touchstone principles are not limited to agency adjudications. Regulations generally carry "the force of law." *United States v. Mead Corp.*, 533 U.S. 218, 226-27 (2001); *see, e.g.*, *Federal Crop Ins. Corp. v. Merrill*, 332 U.S. 380, 385 (1947). For that reason, regulations often feature in purely private disputes. *See, e.g.*, *Encino Motorcars, LLC v. Navarro*, 579 U.S. 211, 218-19 (2016). Of course, the parties may dispute whether the regulations apply or are valid. But since valid regulations are "binding in the courts," *Mead*, 533 U.S. at 227, it is incumbent on courts to resolve *those* questions.

The Sixth Circuit majority's decision turns these principles on their head. The IRS has conceded that § 954(d)(2) may be narrowed through regulations to ensure that it captures only sales income at the heart of the FBCSI exception. *See supra* at 23-24. The parties presented a concrete dispute about the regulations. *See supra* at 13-15. And, as Judge Nalbandian found, the income at issue is *not* FBCSI

under the regulations. *See supra* at 16. The regulations, and the result produced by them, bind the IRS.[5] The majority's decision to impose a tax that the IRS could not itself impose under its own regulations, based on a statute-only approach that was not raised in prior administrative or judicial proceedings, conflicts with the usual rules governing agency action and judicial review thereof.

2. The Sixth Circuit majority's approach likewise raises serious questions of fair notice and upsets settled reliance interests. When the agency that administers a statute provides official, authoritative guidance about the meaning of the statute, the public is generally entitled to rely on it. *See, e.g.*, *Heckler v. Community Health Servs. of Crawford Cnty., Inc.*, 467 U.S. 51, 60 n.12 (1984); *United States v. Pennsylvania Indus. Chem. Corp.*, 411 U.S. 655, 674 (1973). That is, after all, the *purpose* of issuing regulations that are supposed to have the force of law to begin with.

Whirlpool—like countless other taxpayers—relied on the § 954(d)(2) regulations in structuring its Mexican operations to qualify for the maquiladora program without generating FBCSI. And as Judge Nalbandian recognized, Whirlpool does not have FBCSI under the regulations. *See supra* at 16. The Sixth Circuit majority effectively changed the rules post hoc, denying Whirlpool the right to rely on the regulations many years *after* it relied on them because, in the majority's view, § 954(d)(2) standing alone answered the question. Worse, the majority did

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[5] As Judge Nalbandian observed, finding that the income at issue is not FBCSI under the regulations obviates the need to decide whether the regulations are valid. App. 39a n.6.

so sua sponte, without even giving Whirlpool the chance to brief and argue its case under the statute.

This kind of retroactive rule change raises serious due-process concerns, and courts would not tolerate it from agencies or other government officials. *See, e.g.*, *Community Health Servs.*, 467 U.S. at 60 n.12 ("[A]n administrative agency may not apply a new rule retroactively when to do so would unduly intrude upon reasonable reliance interests."); *PHH Corp. v. Consumer Fin. Prot. Bureau*, 839 F.3d 1, 49 (D.C. Cir. 2016) (Kavanaugh, J.) (precluding agency from retroactively enforcing its new interpretation of the statute when entity "acted in reliance upon numerous government pronouncements authorizing precisely the conduct in which [it] engaged"), *reinstated in pertinent part on reh'g en banc*, 881 F.3d 75, 83 (D.C. Cir. 2018) (en banc); *De Niz Robles v. Lynch*, 803 F.3d 1165, 1176 (10th Cir. 2015) (Gorsuch, J.) (forbidding agency from applying new rule announced in adjudication retroactively to avoid "upsetting settled expectations"). It is no less problematic when the retroactive sea change comes from a court that dismisses Congress's express intent in calling for the very regulations it chooses to ignore.

C. The Question Presented Is Exceptionally Important And Warrants This Court's Review

The exceptional importance of this case underscores the need for this Court's review.

1. The tax implications of this case are enormous. Whirlpool alone faces the prospect of tens of millions of dollars of additional tax liability because of the decision below. To the extent the Sixth Circuit majority believed that result is justified because

Whirlpool "avoided any taxation at all," App. 10a, it was plainly wrong. Every penny of the income at issue here will be taxed by the U.S. when it is repatriated. Moreover, the lack of immediate U.S. taxation was *correct* because, as Judge Nalbandian recognized, the income is from manufacturing appliances in Mexico, is not FBCSI under the regulations, and is nothing like the artificially separated sales income that the FBCSI exception targets. *See supra* at 6-7, 16.[6] Whirlpool, like any taxpayer, was entitled to rely on the regulations in "arrang[ing] [its] affairs" so its taxes were "as low as possible; [it was] not bound to choose that pattern which will best pay the Treasury." *Helvering v. Gregory*, 69 F.2d 809, 810 (2d Cir. 1934) (L. Hand, J.).

But many other taxpayers also will feel the sting of the Sixth Circuit's erroneous decision. As numerous commentators have observed, the "stakes" of this case are "enormous." Robert Goulder, Whirlpool*: Have We Reinvented The Branch Rule?*, 106 Tax Notes Int'l 155, 155 (Apr. 4, 2022). For over 50 years, "US-multinationals that operate across different industries, countries, and business models" have made substantial investments abroad in reliance on the § 954(d)(2) regulations. PricewaterhouseCoopers, *IRS Wins Subpart F Case with Wide-Ranging Impact, But Questions Remain* 9 (Aug. 27, 2020).[7] By some estimates, there are

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[6] The foreign tax consequences also followed directly from Luxembourgian and Mexican law and treaties, *see supra* at 11-12 & n.2, the legitimacy of which have never been questioned by the IRS.

[7] Available at https://www.pwc.com/us/en/tax-services/publications/insights/assets/pwc-its-whirpool-sub-f-case.pdf.

thousands of maquiladora companies, and branch structures like those at issue in this case have become "ubiquitous." Herzfeld, *supra*, at 317; Tax Notes Staff, *Whirlpool Sends the Tax World Spinning*, Forbes (Mar. 22, 2022).[8] The Sixth Circuit's decision to disregard the regulations in determining tax liability under § 954(d)(2) "easily" could result in "billions of dollars [in liability] when applied to other similarly situated taxpayers." Goulder, *supra*, at 155.

A broad coalition of amici curiae have filed briefs underscoring the significance of the decision below. The National Association of Manufacturers, for example, stated that its "members have relied on the regulations for over 50 years," and the Sixth Circuit majority's "decision disregarding the manufacturing exception provided by those regulations has the potential to significantly adversely affect NAM's members." NAM CA6 Br. 1-2. The Silicon Valley Tax Directors Group and other organizations together representing thousands of member corporations with an aggregate market capitalization of over $10 trillion likewise explained that this case is exceptionally important because the majority "cast[] doubt on" the planning their members undertook in reliance on "Treasury's branch rule regulations"—planning that implicates "hundreds of billions of dollars of foreign sales" each year. SVTDG CA6 Br. 11.

2. While the significance of the specific issue cannot be overstated, the *way* the Sixth Circuit decided the case greatly magnifies its importance. The majority refused to consider the narrowing regulations explicitly called for by § 954(d)(2),

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[8] Available at https://www.forbes.com/sites/taxnotes/2022/03/22/whirlpool-sends-the-tax-world-spinning/.

effectively rewrote an Act of Congress, and thereby called into question whether regulated parties may continue to rely on regulations implementing the statute. *See* Wilcox, *supra*, at 49 (critiquing "the Sixth Circuit's [unusual] statutory journey in *Whirlpool*"). That decision has serious implications for other statutory and regulatory schemes.

Hundreds of statutes use "under regulations" language to limit the reach of the law and assign to agencies a role in administering those statutes—and still more contain differently worded limitations that are to the same effect. Such limitations are particularly prevalent and important in the tax area. *See* Grewal, *supra* ("Numerous other statutes say that tax benefits will follow 'under regulations' prescribed by the Treasury." (emphasis omitted)). The majority's decision vitiates the role that Congress assigned to agencies pursuant to such statutes and, in the process, "sow[s] severe confusion in an already-confusing area of tax law." *Id.*

The spillover effect from the Sixth Circuit majority's decision is likely to be substantial. That decision was the first "ever denying a taxpayer the ability to rely on final Treasury regulations"—whether promulgated pursuant to a statute expressly effectuated through regulations or not—"let alone ones that have been in effect for over 50 years." Lowell D. Yoder et al., *Implications of the Sixth Circuit's Whirlpool Opinion* (Dec. 21, 2021).[9]

Moreover, it is unlikely that the fallout from the majority's decision can be contained to the tax realm.

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[9] Available at https://www.mwe.com/insights/implications-of-the-sixth-circuits-whirlpool-opinion/.

Agencies issue regulations under all sorts of statutes—and regulated parties must be able to rely on such regulations. *See supra* at 26-29. Yet the majority bypassed regulations that, as Judge Nalbandian found, would have resulted in a complete victory for the taxpayer. *See supra* at 16. It is no wonder that "[p]eople are losing their minds" about the decision in this case. Goulder, *supra*, at 155.

3. Finally, there is no reason to await a circuit conflict on the meaning of § 954(d)(2). As Professor Grewal has explained, "even one circuit court's mistake can wreak havoc on the tax system." Grewal, *supra*. The decision below in effect creates two different tax regimes: one, in the Sixth Circuit, where only § 954(d)(2) applies, and one in the rest of the country where *both* § 954(d)(2) and the regulations apply. This not only will create great uncertainty about the rules governing common foreign corporate arrangements, but subject taxpayers in an already complex area of U.S. tax law to different results based merely on geographic happenstance.

In any event, the conflict with this Court's decisions, coupled with the exceptional importance of this case, alone warrants certiorari. Sup. Ct. R. 10(c).

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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June 30, 2022

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UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

WHIRLPOOL FINANCIAL CORPORATION;
Consolidated Subsidiaries,
Petitioners-Appellants,

v.

COMMISSIONER OF INTERNAL
REVENUE, Respondent-Appellee.

Nos. 20-1899/1900

Argued: June 9, 2021

Decided and Filed: December 6, 2021

19 F.4th 944

Before: NORRIS, KETHLEDGE, and NALBANDIAN, Circuit Judges.

KETHLEDGE, Circuit Judge, delivered the opinion of the court in which NORRIS, Circuit Judge, joined. NALBANDIAN, Circuit Judge (pp. 954-63), delivered a separate dissenting opinion.

OPINION

KETHLEDGE, Circuit Judge.

A subsidiary of Whirlpool Corporation with a single part-time employee in Luxembourg sold refrigerators and washing machines to Whirlpool in a series of complicated transactions. By means of a 2007 corporate restructuring, neither the Luxembourgian subsidiary nor Whirlpool itself paid any taxes on the profits (more than $45 million) earned from those transactions. The IRS later

determined that Whirlpool should have paid taxes on those profits. Whirlpool appealed that determination to the Tax Court, which granted summary judgment to the Commissioner. We affirm.

I.

A.

Before 1962, the income of a foreign subsidiary of an American corporation generally was not subject to taxation in the United States until that income was distributed to the American parent. *See Ashland Oil, Inc. v. Comm'r of Internal Revenue*, 95 T.C. 348, 354 (1990). This regime encouraged American companies to structure their operations so as to shift their income to foreign subsidiaries, whose income would not be subject to taxation in the United States. The American parent could thereby defer indefinitely any taxation in the United States of the income shifted to the foreign subsidiary.

By 1961, the practice of shifting income to foreign subsidiaries for purposes of tax deferral had become widespread among multinational corporations. That year President Kennedy described the problem as follows:

> The undesirability of continuing deferral is underscored where deferral has served as a shelter for tax escape through the unjustifiable use of tax havens such as Switzerland. Recently more and more enterprises organized abroad by American firms have arranged their corporate structures—aided by artificial arrangements between parent and subsidiary regarding intercompany pricing, the transfer of patent licensing rights, the shifting of management

> fees, and similar practices which maximize the accumulation of profits in the tax haven—so as to exploit the multiplicity of foreign tax systems and international agreements in order to reduce sharply or eliminate completely their tax liabilities both at home and abroad.

Message from the President of the United States Relative To Our Federal Tax System, April 20, 1961, *reprinted in* H.R. Doc. No. 87-140, at 6 (1961).

As an example of this practice, suppose that, in 1961, an American company created a subsidiary in a foreign country—say, Mexico—which then manufactured goods for the American parent. If the Mexican subsidiary sold the finished goods directly to the American parent at a price reflecting the cost of manufacturing them, the American parent would pay tax on whatever profit—say, $10 million—that it earned from sales of those goods to third-party vendors. But suppose instead that the American parent created a second subsidiary in a country—say, Switzerland—that did not tax income from sales of goods manufactured elsewhere. The Mexican subsidiary could then sell the goods at a low price to the Swiss subsidiary, which could then sell them to the American parent at a relatively high price. Suppose the Swiss subsidiary's profit on those sales was $6 million. That would shift $6 million of profit from the American parent—whose income was subject to taxation in the United States—to the Swiss subsidiary, whose income (prior to the enactment of the provisions at issue here) was not subject to taxation in its home country or in the United States. The American parent could thereby defer, indefinitely, paying any tax on the $6 million.

Congress sought to prevent this kind of tax avoidance when, in 1962, it enacted Subpart F of the Internal Revenue Code. *See* Revenue Act of 1962, Pub. L. No. 87-834, 76 Stat. 960 (1962), *codified at* 26 U.S.C. §§ 951-965. Subpart F taxes an American corporation directly on certain kinds of income held by its foreign subsidiaries—which Congress referred to as "controlled foreign corporations" ("CFCs"). 26 U.S.C. §§ 954(d)(1), 957. As relevant here, income subject to taxation under Subpart F includes a CFC's foreign base company sales income ("FBCSI"—the acronym is unavoidable here). *See id.* § 954(a)(2).

Under Subpart F of the Code, two provisions determine whether a CFC has generated FBCSI. Section 954(d)(1) treats as FBCSI any income that a CFC derives from certain transactions with a "related person," which the Code defines basically to include entities related to the CFC (either as a parent, subsidiary, or entity controlled by the same entity that controls the CFC). *See id.* § 954(d)(3). The transactions described in § 954(d)(1) are the kinds of transactions within a corporate structure—like the sale of products from the Swiss subsidiary to its American parent in the example described above—that American corporations often used (before the enactment of Subpart F) to defer taxation on income. *See* Joint Committee on Internal Revenue Taxation, *Tax Effects of Conducting Foreign Business Through Foreign Corporations*, JCS-5-61 (1961) ("hereinafter Joint Committee on Taxation").

But under the tax laws of some countries—particularly those that employed a "territorial" system of taxation, under which income generated elsewhere typically is not taxed in the corporation's home country—a corporation could avoid taxation of

income by conducting certain activities (*e.g.*, selling or manufacturing) through a foreign branch or division, rather than through a separate subsidiary. Congress therefore enacted § 954(d)(2), which is a failsafe provision that applies (to paraphrase a very complex provision) when a CFC uses a foreign branch to achieve "substantially the same" tax effect—meaning the same tax-deferral effect—that American corporations had been able to achieve (before 1962) by parking income with a foreign subsidiary. 26 U.S.C. § 954(d)(2); *see also Vetco Inc. v. Comm'r of Internal Revenue*, 95 T.C. 579, 593 (1990). And when the requirements of § 954(d)(2) are met, the income "attributable to" the branch's activities "shall constitute foreign base company sales income of the controlled foreign corporation[,]" 26 U.S.C. § 954(d)(2)—which means that the CFC's American parent is taxed directly on that income.

B.

At all times relevant here, Whirlpool-US owned 100% of Whirlpool Mexico ("Whirlpool-Mex"), which was organized under Mexican law. Whirlpool-Mex in turn owned two Mexican subsidiaries: Commercial Arcos, which performed administrative functions; and Industrias Arcos, which manufactured refrigerators and washing machines for Whirlpool-Mex at two factories in Mexico. Industrias owned the real estate (land and buildings) for the two factories and the equipment used to make the appliances.

Industrias sold the finished appliances to Whirlpool-Mex, which in turn sold most of them to Whirlpool-US. Under Mexican law, Industrias paid a 28% tax on its income from manufacturing the appliances and Whirlpool-Mex paid a 28% tax on its income from its sale of appliances to Whirlpool-US.

Beginning in 2007, however, Whirlpool restructured its Mexican operations to avoid (or at least defer indefinitely) paying taxes on most of the income attributable to its Mexican operations. An express purpose of that restructuring, according to an internal Whirlpool PowerPoint presentation, was "[d]eferral of U.S. taxation of profits earned by [Whirlpool Overseas Manufacturing]." To that end, in May 2007, Whirlpool-US created Whirlpool Overseas Manufacturing ("Lux"), a wholly owned subsidiary organized under the laws of Luxembourg. (Technically, another of Whirlpool's subsidiaries, Whirlpool Luxembourg, owned Whirlpool Overseas Manufacturing. But Whirlpool Luxembourg was primarily a holding corporation. Thus, like the Tax Court, we disregard Whirlpool Luxembourg here.) Whirlpool also created another corporation, this time under Mexican law, called Whirlpool Internacional ("WIN"), which was wholly owned by Lux. WIN had zero employees; Lux had one, who worked part-time in Luxembourg.

Yet—on paper—Whirlpool's manufacturing operations in Mexico were conducted entirely by WIN and Lux. To that end, Industrias and Commercial Arcos "subcontracted" its hourly employees (and "seconded" most of its executives) to WIN. Industrias also sold to WIN parts and tools to manufacture the appliances, and leased to WIN the real estate (again, land and buildings) for Whirlpool's two factories in Mexico. Meanwhile, Industrias sold to Lux its machinery, equipment, and title to works-in-progress (*i.e.*, unfinished appliances) at the two factories. Lux and WIN then entered into an agreement to manufacture the appliances: WIN provided manufacturing services, using Industrias's

subcontracted employees and Lux's equipment (which had been purchased from Industrias); and Lux owned all the raw materials, works-in progress, and finished goods. Lux paid WIN an arm's length fee for WIN's manufacturing services.

Having made an agreement with its own subsidiary (namely WIN), Lux then made one with its parent. Specifically, Lux and Whirlpool-US entered into a Manufacturing Supply Agreement, under which Lux agreed to manufacture appliances according to Whirlpool-US's specifications (which Lux did pursuant to its agreement with WIN); and Whirlpool-US, in turn, agreed to pay Lux "an arms' [sic] length" price for the finished appliances. The agreement further provided that Whirlpool-US would take title to the appliances as soon as they were finished—*i.e.*, while they remained on the factory floor. Lux also entered into an identical agreement with Whirlpool-Mex.

Meanwhile, on the ground in Mexico, nothing changed. The same employers (Industrias and Commercial Arcos) paid the same employees to make the same appliances in the same factories, just as before the restructuring. Only the underlying corporate arrangements had changed.

C.

1.

But those arrangements were hardly arbitrary. In large part they tracked the requirements of Mexico's "Maquiladora Program," which (among other benefits) offered reduced tax rates for "foreign principals" (*i.e.*, a foreign corporate parent) that met its requirements. To qualify, the foreign principal (in our case Lux, a CFC of Whirlpool-US) was required to

enlist a Mexican subsidiary—known as the "maquiladora" (in our case WIN)—to perform the principal's manufacturing activities at a location in Mexico. The foreign principal was also required to provide all the necessary raw materials; to own the component parts and works-in-progress; to take title to the finished goods; and then to export them. If those requirements were met, Mexico would tax the maquiladora at a 17% rate, rather than the usual 28%.

The foreign principal could also benefit directly from the program. Normally, under Mexican law, a foreign corporation with a "permanent establishment" in Mexico—*e.g.*, a factory there—paid tax at a 28% rate on income attributable to that establishment (for example, profit from foreign sales of goods manufactured in Mexico). But if (among other requirements) a foreign principal paid its Mexican subsidiary an arm's length price for its manufacturing services, then Mexico would deem the principal *not* to have a permanent establishment in Mexico—which meant that the principal would be exempt from taxation there.

Whirlpool's restructured operations in Mexico met the requirements of the Maquiladora Program. WIN performed Lux's manufacturing activities at two locations in Mexico; Lux owned the raw materials, parts, and works-in-progress; and Lux held title to the finished goods, which (as to most of the appliances) it immediately conveyed to Whirlpool-US. Moreover, Lux paid WIN an arm's-length price for its manufacturing services, with the result that Lux paid no tax in Mexico on its profit from sales of the finished appliances to Whirlpool-US. In 2009—the tax year at

issue here—Lux's profit on those sales exceeded $45 million.

2.

What caught the attention of the IRS, however, was not that Lux paid no tax on that profit in Mexico, but that Lux and Whirlpool-US paid no tax on that profit at all. For there remains the curious fact that WIN's parent company was organized not in the United States or some other country in which Whirlpool had a meaningful presence, but in Luxembourg—a country in which there occurred nothing of consequence to Whirlpool's operations save the performance of administrative tasks by a single part-time employee. Corporations in Luxembourg normally paid a 28% tax on their income. But Luxembourg happened to have a treaty with Mexico, under which Luxembourgian companies paid no tax in Luxembourg on income attributable to the activities of a permanent establishment in Mexico. *See* Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, Lux.-Mex., Feb. 7, 2001, Arts. 7(2), 23(1)(A).

Lux had already obtained from Mexican authorities a determination that it did not have a permanent establishment in Mexico. Yet Lux represented to Luxembourgian authorities that it *did* have a "fixed place of business" in Mexico (namely the two factories whose land and buildings Industrias had leased to WIN); that "[t]he people located in Mexico have all the necessary powers to execute contracts in the name and on behalf of [Lux] without any need to refer to the head-office" in Luxembourg; and that, "[t]herefore, [Lux] is considered *having a permanent establishment in Mexico* according to the provisions of

article 5 of the Convention between Mexico and [Luxembourg] for the avoidance of double taxation[.]" (Emphasis added.) Lux did not disclose to the Luxembourgian authorities, however, that the Mexican authorities had made the opposite determination—that Lux did *not* have a permanent establishment in Mexico.

Based on Lux's submission, the Luxembourgian authorities determined that Lux had a permanent establishment in Mexico. Lux therefore avoided not merely "double taxation" in Mexico and Luxembourg on its $45 million in profits from sales of appliances to Whirlpool-US; instead, it avoided any taxation at all.

3.

That left the United States as a jurisdiction in which Lux might be taxed on that $45 million. But WIN elected to be a "disregarded entity" for purposes of American tax law, *see* 26 C.F.R. § 301.7701-2(a), meaning (as an initial matter at least) that, for those purposes, WIN would be regarded as part of Lux itself—rather than as a separate entity and thus a "related person" under § 954(d)(1). In any event, Whirlpool Corporation represented on its 2009 tax return that none of Lux's income from its sales to Whirlpool-US (or anyone else) was FBCSI.

D.

The IRS thereafter disagreed with that representation and determined that Lux's 2009 sales income was FBCSI that should have been included in Whirlpool's income for that year. The IRS issued deficiency notices to Whirlpool accordingly. Whirlpool filed petitions in the Tax Court challenging the IRS's determination. The parties filed cross-motions for

summary judgment, which the Tax Court decided in a meticulously reasoned 62-page opinion. The Tax Court granted summary judgment to neither party as to the question presented under § 954(d)(1), holding that genuine issues of material fact existed as to the application of that provision. But the Tax Court granted summary judgment to the Commissioner under § 954(d)(2), holding that "the bare text of the statute, literally read, indicates that [Lux's] sales income is FBCSI that must be included in petitioners' income under subpart F." Op. at 40. The court also determined that the IRS's implementing regulations "yield the same result by a more complicated process." Op. at 42. The Tax Court therefore entered orders upholding the deficiencies.

This appeal followed.

II.

We review de novo the Tax Court's grant of summary judgment in favor of the IRS. *See Golden v. Comm'r of Internal Revenue*, 548 F.3d 487, 492 (6th Cir. 2008). Absent some ambiguity incapable of resolution by means of all the tools of statutory construction, we give effect to our interpretation of the statute without regard to any divergent interpretations offered by the agency. *See Montgomery County v. F.C.C.*, 863 F.3d 485, 489 (6th Cir. 2017). There is no such ambiguity here.

A.

The question presented is whether Lux's income from its sales of appliances to Whirlpool-US and Whirlpool-Mexico in 2009 is FBCSI under § 954(d)(2). That provision provides in full:

> **Certain branch income.** For purposes of determining foreign base company sales income

> in situations in which the carrying on of activities by a controlled foreign corporation through a branch or similar establishment outside the country of incorporation of the controlled foreign corporation has substantially the same effect as if such branch or similar establishment were a wholly owned subsidiary corporation deriving such income, under regulations prescribed by the Secretary the income attributable to the carrying on of such branch or similar establishment shall be treated as income derived by a wholly owned subsidiary of the controlled foreign corporation and shall constitute foreign base company sales income of the controlled foreign corporation.

As the Tax Court aptly observed, § 954(d)(2) consists of a single (nearly interminable) sentence that specifies two conditions and then two consequences that follow if those conditions are met. The first condition is that the CFC was "carrying on" activities "through a branch or similar establishment" outside its country of incorporation. The second condition is that the branch arrangement had "substantially the same effect as if such branch were a wholly owned subsidiary corporation [of the CFC] deriving such income[.]" If those conditions are met, then two consequences follow as to "the income attributable to" the branch's activities: first, that income "shall be treated as income derived by a wholly owned subsidiary of the controlled foreign corporation"; and second, the income attributable to the branch's activities "shall constitute foreign base company sales income of the controlled foreign corporation." 26 U.S.C. § 954(d)(2).

1.

We begin with the conditions. The first condition—that Lux "carr[ied] on" activities "through a branch or similar establishment" outside its country of incorporation—is undisputedly met here. Lux (the CFC) was a Luxembourgian corporation acting through WIN in Mexico; and WIN itself, through its disregarded-entity election in 2009, asked to be treated as a branch (rather than a subsidiary) of Lux for federal tax purposes.

To meet the second condition, the branch arrangement must have had "substantially the same effect as if such branch or similar establishment were a wholly owned subsidiary deriving" the income attributable to the branch's activities. *Id.* The meaning of that phrase presents the principal interpretive question in this appeal.

We construe statutory text as it would have been understood "at the time Congress enacted the statute." *Wisconsin Central Ltd. v. U.S.*, — U.S. —, 138 S.Ct. 2067, 2070, 201 L.Ed.2d 490 (2018) (cleaned up). And "when a statute, like this one, is 'addressing a technical subject, a specialized meaning is to be expected.' " *Van Buren v. United States*, — U.S. —, 141 S.Ct. 1648, 1658 n.7, 210 L.Ed.2d 26 (2021) (cleaned up) (quoting Scalia & Garner, *Reading Law* 73 (2012)). Thus we ask what " 'an appropriately informed' speaker of the language would understand" that specialized meaning to be. *Van Buren*, 141 S.Ct. at 1657 (quoting Nelson, *What is Textualism?*, 91 Va. L. Rev. 347, 354 (2005)).

The phrase at issue here—"substantially the same effect as if such branch or similar establishment were a wholly owned subsidiary deriving such income"—

would have resonated loudly with an informed reader when Subpart F was enacted in 1962. The year before, as noted above, President Kennedy had deplored the growing use of "artificial arrangements between parent and subsidiary regarding intercompany pricing, the transfer of patent licensing rights, the shifting of management fees, and similar practices which maximize the accumulation of profits" in tax havens "so as to exploit the multiplicity of foreign tax systems and international agreements in order to reduce sharply or eliminate completely their tax liabilities both at home and abroad." Message from the President of the United States Relative To Our Federal Tax System, April 20, 1961, *reprinted in* H.R. Doc. No. 87-140, at 6 (1961).

In response to the president's speech, the staff of the Joint Committee on Internal Revenue Taxation issued a report, dated July 21, 1961, on the use of foreign subsidiaries by multinational American corporations to defer the taxation of income. That report likewise observed: "by conducting its foreign operations though a corporation organized under the laws of a foreign country an American parent corporation can postpone the tax on income earned by a foreign subsidiary until that income is returned to the U.S. parent as dividends or otherwise." Joint Committee on Taxation, at 5.

The Joint Committee's report described in detail various ways that American corporations at that time had actually used foreign subsidiaries to defer taxation of income. To cite one notable example of many in the report, an American corporation was "engaged in the manufacture and sale of various types of machines and equipment which [were] sold to companies in the United States and in many foreign

countries[.]" *Id.* at 11. The American corporation established a "foreign subsidiary corporation" with "headquarters in a country which ha[d] no income tax." *Id.* The American corporation then shifted income to the foreign subsidiary "to obtain 'a greater immediate cash flow resulting from tax deferral which could be used to finance the expansion of overseas business.' " *Id.* at 12. (quoting "[r]epresentatives" of the foreign subsidiary). The report separately discussed "a foreign subsidiary which manufacture[d] for its American parent parts or finished products which it then [sold] to the American parent corporation for distribution in the United States"; and the report noted that, "[t]o the extent that the foreign subsidiary charges a disproportionately high price, its income will be unrealistically high and the income of the American parent will be unrealistically low." *Id.* at 13.

The report also observed that "in many cases the abuse resulting from the use of a foreign subsidiary consists in the fact that the foreign subsidiary has little, if any substance and does not, in fact, function as an operating commercial corporation." *Id.* at 15. For example, one American manufacturer "organized an international subsidiary under the laws of Liechtenstein which, nominally at least," performed sales operations "throughout the world" for its American parent. *Id.* Although the Liechtenstein subsidiary "employ[ed] few, if any, salesmen," it received up to "80 percent" of the income from the American company's foreign operations. As to this example, the report concluded: "[T]he profits thus allocated to the Liechtenstein corporation are grossly disproportionate to the real value of what little work that corporation does." *Id.*

In a statement submitted to Congress in 1961, the Secretary of the Treasury similarly emphasized the recent "proliferation of corporate entities in tax haven countries, like Switzerland." Statement of Douglas Dillon, Secretary of the Treasury, before the House Ways and Means Committee *reprinted in* Joint Committee on Taxation 21, 23 (1961). "[I]n the year ended March 31, 1961" for example, American companies created 170 new subsidiaries in Switzerland—an increase of more than 50%. *Id.* "Increasingly," the Secretary observed, "U.S. manufacturing subsidiaries operating elsewhere . . . are being linked to subsidiaries in the tax haven countries." *Id.* The Commissioner of Internal Revenue likewise observed in a 1961 memorandum: "In recent years the number of foreign corporations owned directly or indirectly by U.S. shareholders has increased rapidly." Memorandum of Comm'r of Internal Revenue dated June 22, 1961, *reprinted in* Joint Committee on Taxation 28, 28 (1961). And though the Service had difficulty distinguishing subsidiaries that had "real business purposes" from those that did not, the Commissioner was certain that "some ha[d] been organized for the sole purpose of avoiding the payment of U.S. taxes that would otherwise be due." *Id.*

In this historical context, an informed reader would have understood the phrase at issue here—"substantially the same effect as if such branch or similar establishment were a wholly owned [foreign] subsidiary deriving such income"—to be nearly a term of art. The practice of shifting income to "wholly owned subsidiar[ies]" overseas was associated, above all, with one "effect": tax deferral. Subpart F in general and § 954 in particular are overwhelmingly

focused on preventing precisely that effect. Thus, as a matter of historical and statutory context alike, an informed reader would naturally understand the "effect" to which § 954(d)(2) refers to be a *tax-deferral effect*. We therefore agree with the Tax Court that the phrase "substantially the same effect," as used in § 954(d)(2), refers to the "deferral of tax" on sales income. Op. at 954. Indeed, no one in this appeal disputes that aspect of the Tax Court's reasoning.

The second condition of § 954(d)(2), then, is that the CFC's "carrying on of activities" through a foreign branch had a substantial tax-deferral effect. That condition is plainly met here: the Tax Court found—and Whirlpool again does not dispute—that, "[b]y carrying on its activities 'through a branch or similar establishment' in Mexico, [Lux] avoided *any* taxation of its sales income." *Id*. (emphasis added). Indeed, as noted above, an express purpose of Whirlpool's 2007 restructuring was "[d]eferral of U.S. taxation of profits earned by [Lux]."

Meanwhile, Whirlpool does not dispute that Lux's income from its sales of appliances to Whirlpool-US and Whirlpool-Mexico in 2009 was "attributable to" the activities of its Mexican branch. To the contrary, Whirlpool itself contends (albeit in a different context) that "the income at issue constituted income attributable to the Manufacturing [*i.e.*, Mexican] Branch and not [Lux]." Whrlpl. Br. 51.

From these premises, § 954(d)(2) expressly prescribes the consequences that follow: first, that the sales income "attributable to" the "carrying on" of activities through Lux's Mexican branch "shall be treated as income derived by a wholly owned subsidiary" of Lux; and second, that the income attributable to the branch's activities "shall

constitute foreign base company sales income of" Lux. That second consequence directly answers the question presented in this appeal.

We acknowledge that § 954(d)(2) states that, if the provision's two conditions are met, then "under regulations prescribed by the Secretary" the provision's two consequences "shall" follow. And Whirlpool makes various arguments as to those regulations, seeking a result different from the one mandated by the statute itself. But the agency's regulations can only implement the statute's commands, not vary from them. (The Tax Court read the "under regulations" text the same way. *See* Op. at —— ("The Secretary was authorized to issue regulations implementing these results.")). And the relevant command here—that Lux's sales income "shall constitute foreign base company sales income of" Lux—could hardly be clearer.

Our dissenting colleague—in a thoughtful opinion, in this difficult case—reads the "under regulations" text to condition the two commands (the "shall[s]") that follow. But that reading would delegate to the Secretary unfettered discretion to determine whether *any* consequences follow when the two conditions of § 954(d)(2) are met. That would amount to a power to do much more than "fill up the details." *Wayman v. Southard*, 23 U.S. (10 Wheat.) 1, 43, 6 L.Ed. 253 (1825) (Marshall, C.J.). The dissent also argues that our reading of § 954(d)(2) would allow income from sources other than sales—for example, interest income—to be treated as FBSCI. But perhaps here the acronym gets in the way. Section 954(d)(2) twice refers not merely to "income," but to "foreign base company *sales* income"—which makes clear enough the provision is confined to income from sales. We

therefore agree with the Tax Court that, under the text of the statute alone, "[Lux's] sales income is FBCSI that must be included in petitioners' income under subpart F." Op. at 949.

2.

Whirlpool's remaining arguments in opposition to that conclusion are insubstantial. First, Whirlpool argues that § 954(d)(2) allows only "income of the branch"—as opposed to income held, as here, by the CFC—to be treated as FBCSI of the CFC. Whrlpl. Br. 30. But that argument glosses over the words of the provision itself. Section 954(d)(2) says that, if the provision's two conditions are met, "the income *attributable to*" the branch's activities "shall be treated as income derived by a wholly owned subsidiary and shall constitute foreign base company sales income of the [CFC]." (Emphasis added.) "Attributable" means "resulting from[.]" *The Random House Dictionary of the English Language* 96 (1966); *see also, e.g.*, *The Am. Heritage Dictionary* 86 (1969) (same). Thus, for income to be "attributable to" a branch's activities, the branch itself need not hold or obtain the income; rather, the income need only result from the branch's activities. And here, as Whirlpool itself has conceded, Lux's sales income resulted from the activities of its Mexican branch, as opposed to the activities of Lux's single part-time employee. That income was therefore was "attributable to" the branch's activities.

Whirlpool also invokes the heading of § 954(d)(2): "Certain branch income." But that phrase can easily be construed to comprise income attributable to a branch as well as income held by it. More to the point, the provision's text says "attributable to"; and " 'the heading of a section cannot limit the plain meaning

of the text.' " *United States v. Michael*, 882 F.3d 624, 629 (6th Cir. 2018) (quoting *Bhd. of R.R. Trainmen v. Baltimore & O.R. Co.*, 331 U.S. 519, 528-29, 67 S.Ct. 1387, 91 L.Ed. 1646 (1947)). Whirlpool's argument is without merit.

Second, Whirlpool argues that § 954(d)(2) standing alone cannot support a determination that Lux's sales income is FBCSI. On this point Whirlpool first cites the introductory clause of § 954(d)(2), which reads: "For purposes of determining foreign base company sales income[.]" Whirlpool then points to § 954(d)(1), which states that "foreign base company sales income means income" from four types of transactions involving a "related person[.]" Thus, in Whirlpool's view, if the conditions of § 954(d)(2) are met, the transaction at issue must still fit within one of the four types of transactions described in § 954(d)(1)—when treating the branch as a "wholly owned subsidiary of the [CFC,]" as prescribed in the first consequence of § 954(d)(2)—in order for the income from the transaction to be treated as FBCSI of the CFC.

But that argument overlooks the structure of the two provisions and the emphatic terms of § 954(d)(2) itself. Section 954(d)(1) sets forth a general rule: it identifies four types of transactions that tend to result in tax deferral, and says that income resulting from them is FBCSI. Section 954(d)(2), in contrast, sets forth a special rule—one that applies (to pick up where the introductory clause leaves off) "in situations in which the carrying on of activities by a controlled foreign corporation through a branch or similar establishment outside the country of incorporation of the controlled foreign corporation has substantially the same effect as if such branch or

similar establishment were a wholly owned subsidiary corporation deriving such income[.]" As explained above, that "situation" already includes—as the provision's second condition—the circumstance that the branch arrangement results in a deferral of tax on sales income. Thus, whereas § 954(d)(1) involves an intermediate step for determining whether a transaction results in tax deferral—namely, the determination whether the transaction at issue is of a type that tends to cause that result—§ 954(d)(2) cuts to the bottom line of deferral itself. And having cut to that bottom line, § 954(d)(2)'s terms are peremptory: if the provision's two conditions are met, the income at issue "*shall constitute foreign base company sales income of the [CFC]*." (Emphasis added.) We have no license or reason to read into § 954(d)(2)'s introductory clause a putative implication that renders meaningless that statutory command. Here, § 954(d)(2)'s conditions are met; the consequences that follow are clear from the statute itself.

* * *

The Tax Court's judgment is affirmed.

DISSENT

NALBANDIAN, Circuit Judge, dissenting.

This is a hard case. It involves a complicated statute and an even more complicated set of regulations. The majority thoughtfully engages with both and comes to a reasoned conclusion. But I see this case differently. In my view, LUX didn't generate taxable foreign base company sales income because it "manufactured" the property it bought and sold. *See*

26 C.F.R. § 1.954-3(a)(4)(ii).[1] And that's true even if we shuffle the relevant transactions under 26 U.S.C. § 954(d)(2). Thus, I dissent.

I.

This case is about statutory interpretation. There are two relevant statutory provisions, 26 U.S.C. §§ 954(d)(1) and (d)(2). The majority relies on the latter to hold that LUX generated FBCSI. But the key here is solving the relationship between these two provisions. To that end, I start with some brief background.

Before Congress passed the Revenue Act of 1962, income a foreign corporation earned from sources outside the United States generally was not subject to federal tax, even if an American shareholder controlled the corporation. *See Dave Fischbein Mfg. v. Comm'r*, 59 T.C. 338, 353 (1972). Predictably, this led to the use of "tax havens"—countries "within which only minimal business operations were carried on in order to insulate income from U.S. tax." *Vetco Inc. v. Comm'r*, 95 T.C. 579, 585 (1990). In other words, the Revenue Code allowed multinational corporations to "realize substantial tax savings by using a subsidiary organized in a tax haven as a base for its foreign operations." Eric T. Laity, *The Foreign Base Company Sales Income of Controlled Foreign Corporations*, 31 Cornell Int'l L. J. 93, 94 (1998).

As the majority points out, Congress tried to rein some of this in with the Revenue Act of 1962. The Act

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[1] The regulations at issue changed in 2008. But the Tax Court found that Whirlpool elected to proceed under the *old* regulations and not the new ones. The Commissioner does not challenge that on appeal. (Appellee Br. at 71–72 n.25.) So this opinion relies on the regulations as they formerly existed.

added Subpart F income to the Internal Revenue Code. *Vetco*, 95 T.C. at 585–86; *see generally* 26 U.S.C. § 951 et seq. As a result, U.S. shareholders of "controlled foreign corporations" (CFCs) must pay taxes on their pro rata share of the CFC's Subpart F income.[2] *Vetco*, 95 T.C. at 585–86; *see* 26 U.S.C. § 951(a)(1)(A).

What is Subpart F income? It comes in several forms. Relevant here, Subpart F income includes "foreign base company income." *See* 26 U.S.C. § 952(a)(2). And foreign base company income includes "foreign base company *sales* income," which we call FBCSI. *Id.* § 954(a)(2) (emphasis added). Thus, U.S. shareholders of a CFC must pay their pro rata share of taxes on the CFC's FBCSI. *See id.* §§ 951(a)(1)(A), 952(a)(2), 954(a)(2). Translated into more familiar terms, Whirlpool must pay its pro rata share of LUX's foreign base company sales income. So whether Whirlpool owes taxes on LUX's income depends on whether that income qualifies as FBCSI.

A.

I don't believe LUX generated FBCSI here. FBCSI comes in two forms. The first is income from a Related-Person Transaction.[3] *See* 26 U.S.C. § 954(d)(1). Under § 954(d)(1), FBCSI is "income derived in connection with" four types of related-person sales transactions:

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[2] A CFC is a foreign corporation for which a U.S. shareholder owns more than half of the voting power or total value of the corporation. *See* 26 U.S.C. § 957(a). LUX is a CFC of Whirlpool.

[3] A related person is "any entity that controls, is controlled by, or is under common control with" a CFC. Laity, *supra* at 95; *see also* 26 U.S.C. § 954(d)(3).

1. The purchase of personal property from a related person and its sale to anyone;
2. The purchase of personal property from anyone and its sale to a related person;
3. The sale of personal property to anyone on behalf of a related person; or
4. The purchase of personal property from anyone on behalf of a related person.

"Section 954(d)(1) sets forth the general rule defining FBCSI" by laying out these four triggering transactions. *Vetco*, 95 T.C. at 590. But perhaps aware that "Americans have never had much enthusiasm for paying taxes," *CIC Servs., LLC v. I.R.S.*, —— U.S. ——, 141 S. Ct. 1582, 1586, 209 L.Ed.2d 615 (2021), Congress also enacted 26 U.S.C. § 954(d)(2), the Branch Rule. That Rule is designed to prevent CFCs from skirting § 954(d)(1) by transacting with a *branch* instead of a wholly owned subsidiary. *See Vetco*, 95 T.C. at 593. That's because a branch isn't a "related person" under § 954(d)(3), *see id.* at 591–92, meaning a CFC's transaction with a branch wouldn't trigger (d)(1) because (d)(1) requires a transaction with a related person. *See* 26 U.S.C. § 954(d)(1).

The majority reads (d)(1) and (d)(2) as independent of each other. In other words, both (d)(1) and (d)(2), of their own force, define FBCSI. But I disagree. Instead, I read § 954(d)(2)'s text and structure as directing us back into the (d)(1) framework. And that framework features an exception to FBCSI (the Manufacturing Exception) that I believe LUX satisfies here. At the very least, there's a disputed question of material fact whether

the Exception applies. And so I think summary judgment for the Commissioner is inappropriate.

B.

The majority says LUX generated FBCSI through the Branch Rule. So let's look at the Rule's complicated text.[4] It kicks in when a CFC's "carrying on of activities . . . through a branch or similar establishment outside the [CFC's] country of incorporation . . . has substantially the same effect as if such branch or similar establishment were a wholly owned subsidiary corporation." 26 U.S.C. § 954(d)(2). When the Rule is triggered, "under regulations prescribed by the Secretary [of the Treasury] the income attributable to the carrying on" of the branch's activities is "treated as income derived by a wholly owned subsidiary of the" CFC and "shall constitute" FBCSI of the CFC. *Id.*

The majority reads this as a simple set of conditions and consequences—the most important consequence being that certain income "shall

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[4] In full, the provision reads:

> For purposes of determining foreign base company sales income in situations in which the carrying on of activities by a controlled foreign corporation through a branch or similar establishment outside the country of incorporation of the controlled foreign corporation has substantially the same effect as if such branch or similar establishment were a wholly owned subsidiary corporation deriving such income, under regulations prescribed by the Secretary the income attributable to the carrying on of such activities of such branch or similar establishment shall be treated as income derived by a wholly owned subsidiary of the controlled foreign corporation and shall constitute foreign base company sales income of the controlled foreign corporation.

26 U.S.C. § 954(d)(2).

constitute" taxable FBCSI. So if a CFC's use of a branch satisfies the statutory conditions, (d)(2)'s mandate is clear: The income earned "shall constitute" FBCSI.

But I'm not so sure that's the right reading. Instead, the statutory structure only makes sense if (d)(2) transactions filter back through (d)(1)'s framework, including its Manufacturing Exception. Moreover, § 954(d)(2) *explicitly* tells us that income a CFC earns through a branch "shall constitute" FBCSI "*under regulations prescribed by the* Secretary [of the Treasury]." 26 U.S.C. § 954(d)(2) (emphasis added). And § 954(d)(2)'s regulations instruct us to subject a (d)(2) transaction to (d)(1)'s framework and exceptions. *See* 26 C.F.R. § 1.954-3(b)(2)(ii)(e).

Let me explain. At its core, § 954(d)(2) creates a fiction. It takes certain *branches* of a CFC and treats them as *wholly owned subsidiaries*. That's because, as I already mentioned, a branch isn't a "related person" within (d)(1). *See Vetco*, 95 T.C. at 591–92; *see also* 26 U.S.C. § 954(d)(3). And so Congress included the Branch Rule in § 954(d) "to prevent CFCs from avoiding section 954(d)(1) because there would be no transaction with a related person within the meaning of section 954(d)(3)." *Vetco*, 95 T.C. at 593. Put differently, § 954(d)(2) "*simply supplies the relationship* required to bring an otherwise unrelated party within the spectrum of section 954(d)(1)." *Id.* at 591–92 (emphasis added). That's why § 954(d)(2)'s fiction treats branches as wholly owned subsidiaries—the latter is a "related person" subject to § 954(d)(1). *See id.*; *see also* § 954(d)(3). Thus, I think that if we have a (d)(2) transaction—i.e., a qualifying branch-remainder transaction—we still need to make sure there is a (d)(1) transaction. And

we also need to check and see if any of (d)(1)'s regulatory exceptions apply.

To explain, let's look again at the text of (d)(2). It starts by noting why it exists: "For purposes of determining [FBCSI]"—which (d)(1) defines by reference to four types of Related-Person Transactions. 26 U.S.C. § 954(d)(2); *see id.* § 954(d)(1). Then it creates the wholly-owned-subsidiary fiction—treating a branch as a wholly owned subsidiary—before saying that "the income attributable" to the branch's activities "shall constitute" FBCSI of the CFC.

At first glance, then, it looks like (d)(2) might suffice on its own to create FBCSI, which is the majority's view. After all, the last clause in the provision says income attributable to a branch's activities "shall constitute" FBCSI. So, as the majority notes, "the statutory command . . . could hardly be clearer." But this reading of "shall constitute" is problematic for a few reasons.

For starters, § 954(d)(2) modifies "shall constitute" with "under regulations prescribed by the Secretary." *See* 26 U.S.C. § 954(d)(2). Read naturally, then, the provision says that "income attributable" to the branch's activities "shall constitute" FBCSI "under regulations prescribed by the Secretary." This means that Congress gave Treasury a role in defining when branch transactions generate FBCSI. So the "statutory command" isn't quite what the majority makes it out to be. And as I explain below, the regulations applicable here tie (d)(2) back into (d)(1) and instruct us to apply the Manufacturing Exception to the (d)(2) transaction.

But before turning to those regulations, let's stay in the text. If "shall constitute" is enough by itself to label income FBCSI, then all sorts of income would be open to designation as FBCSI, *even if no sales transaction occurred*. (An odd result, given that § 954(d) is all about *sales* income.) That's because nothing in (d)(2) cabins the type of income Treasury could target. All it says is "income attributable" to the branch's activities could be FBCSI. This causes both a conceptual and a practical problem. Conceptually, (d)(1) defines FBCSI by reference to certain Related-Person Transactions. And (d)(2) starts off by noting that it's there "[f]or purposes of determining foreign base company sales income" when a CFC uses a branch. 26 U.S.C. § 954(d)(2). But if Treasury could designate income as FBCSI even with no Related-Person Transactions occurring, the internal logic of the statute would collapse. Income arising *apart from* a Related-Person Transaction is FBCSI, even though FBCSI is defined directly by reference to Related-Person Transactions.

Maybe (d)(1) isn't the only provision that's allowed to define FBCSI. So (d)(2), just like (d)(1), can designate something FBCSI. But that still causes a practical problem. Reading "shall constitute" without applying the (d)(1) framework gives no insight into *which* branch transactions generate FBCSI. Besides "income attributable to a branch's activities," there is no relevant referent from which to calculate a CFC's tax liability. What activities generate FBCSI, and how much of the income from those activities is taxable? Under a literal reading of "shall constitute," *any* activity could generate FBCSI, no matter if it involves a Related-Person sales transaction, so long as it's "attributable" to the branch's activities. Again,

that's an odd result when we're trying to determine if a transaction generated foreign base company *sales* income.

Perhaps this abuse is unlikely. After all, what income but sales income would even arise in this context? But this case is a good example of why abuse is at least *possible*. One of LUX's functions is financing other Whirlpool subsidiaries. And it generates considerable interest income from its inter-company loans. Could interest income LUX earns from a loan to WIN constitute FBCSI? If it is "income attributable to the carrying on" of WIN's activities, then it would be FBCSI under a literal reading of (d)(2)'s last clause. And if WIN's manufacturing income enables it to pay LUX interest on its financing, and WIN was created by inter-company financing, perhaps LUX's interest income would be "income attributable to" WIN's activities and thus FBCSI

So reading "shall constitute" to mean (d)(2) transactions generate FBCSI without reference to a (d)(1) transaction raises fundamental problems. And it renders part of § 954(d)(2) superfluous. *See* Antonin Scalia & Bryan A. Garner, Reading Law: The Interpretation of Legal Texts 174 (2012). Indeed, if "shall constitute" can independently create FBCSI, then what purpose does the "wholly owned subsidiary" fiction from § 954(d)(2) serve? Remember, that fiction "supplies the relationship required to bring an otherwise unrelated party within the spectrum of section 954(d)(1)." *Vetco*, 95 T.C. at 591–92. But if "income attributable" to the branch's activities "shall constitute" FBCSI even without applying (d)(1), the wholly-owned-subsidiary fiction becomes useless. Perhaps this is why even the government here agrees with this reading of (d)(2).

(*See* Appellee Br. at 34–35 & n.14.) On the other hand, if we read (d)(2) as the Tax Court did in *Vetco* to supply a missing Related-Person relationship—running the branch transaction through the (d)(1) framework—that allows us to account for the fiction.

Would my reading make "shall constitute" superfluous? No. Remember, § 954(d)(2) modifies "shall constitute" with "under regulations prescribed by the Secretary." *See* 26 U.S.C. § 954(d)(2). So "income attributable" to the branch's activities "shall constitute" FBCSI "under regulations prescribed by the Secretary." We can easily read "shall constitute" in context as giving Treasury a role in defining when branch transactions generate FBCSI. In fact, Treasury has already accepted that invitation. And as it happens, the regulations it issued tie (d)(2) back into (d)(1) and instruct us to apply (d)(1)'s exceptions to the (d)(2) transaction. The upshot of that is this: LUX qualifies for one of these exceptions and so didn't generate FBCSI here.

C.

Let's turn to the regulations. The relevant (d)(2) manufacturing branch regulations have two main parts. The first tells us how to determine whether the use of a branch has substantially the same effect as use of a subsidiary. 26 C.F.R. § 1.954-3(b)(1)(ii)(b). It does so with a "tax rate disparity" test. If, under the test, a tax rate disparity exists, then use of a branch has "substantially the same effect" as use of a wholly owned subsidiary. *See id.*; 26 U.S.C. § 954(d)(2). Completing that Step 1 analysis is unnecessary for my argument here.

Assuming a tax rate disparity exists under Step 1, Step 2 of the regulations kicks in. *Id.* § 1.954-

3(b)(2)(ii). Under Step 2, "the determination of whether [the branch] or the remainder of the [CFC] . . . has [FBCSI] shall be made by applying" certain rules. *Id.* The regulation then lists those rules. *See id.* § 1.954-3(b)(2)(ii)(a)–(f). For instance, just like (d)(2), the regulation tells us to treat the branch as a wholly owned subsidiary incorporated in its country of location. *Id.* § 1.954-3(b)(2)(ii)(a). It also tells us to treat a sale by the remainder as a sale performed "on behalf of" the branch. *Id.* § 1.954-3(b)(2)(ii)(c). (Note that an on-behalf-of sale is one of the four categories of transactions that generates FBCSI under § 954(d)(1).) Likewise, it tells us that if income is FBCSI under (d)(1), or is FBCSI under a different regulation, then we should not recount it again under (d)(2)'s manufacturing branch rule. *Id.* § 1.954-3(b)(2)(ii)(d), (f). And finally, it tells us that if income would not be FBCSI if the branch and remainder were separate corporations, then it's not FBCSI under § 954(d)(2). *Id.* § 1.954-3(b)(2)(ii)(e).

But that's it. After applying those rules, we reach the end of the rope. But notice what's missing: Anything stating that specific income is FBCSI. The (d)(2) regulations instruct us to apply certain fictions to the branch and remainder, but then they stop. So Step 2 of the (d)(2) manufacturing branch regulations—which we apply when determining "whether such branch . . . or remainder . . . has [FBCSI]"—just tells us to treat the branch and remainder as separate corporations and view the remainder's sales as performed "on behalf of" the branch. It doesn't say *which* branch transactions to look at when determining whether a CFC has FBCSI. Nor does it, of its own force, label any income FBCSI.

The only logical reason for this is that the regulation expects the (d)(2) transaction to filter back through the (d)(1) framework. Indeed, the regulation gives us the exact ingredients we need to make out a (d)(1) transaction. We have related persons, *see id.* § 1.954-3(b)(2)(ii)(a) (treating the branch as a wholly owned subsidiary), and we have a (d)(1) transaction, *see id.* § 1.954-3(b)(2)(ii)(c) (treating the remainder's selling activities as done on behalf of the branch); *see also* 26 U.S.C. § 954(d)(1). We just don't have a provision calling anything FBCSI unless we look back to (d)(1)'s framework.

Even if that weren't enough to establish that (d)(2) filters back through (d)(1), the regulation leaves little doubt. It explicitly tells us to apply the (d)(1) *exceptions* to the (d)(2) transaction. "Income derived by the branch . . . or by the remainder . . . shall not be considered [FBCSI] if the income *would not be so considered if it were derived by a separate controlled foreign corporation under like circumstances*." *Id.* § 1.954-3(b)(2)(ii)(e) (emphasis added). This provision implies that "the results to a CFC [can] be no worse off as a result of using a branch than of using a wholly-owned subsidiary." Mary F. Voce, *Foreign Base Company Sales Income: A Primer and An Update*, 53 Tax Lawyer 327, 349 (2000). Put differently, if treating the branch and remainder as separate companies (and related persons) means the transaction at issue would *not* generate FBCSI under (d)(1), then neither will the transaction generate FBCSI under (d)(2). *See id.* And because (d)(1)'s exceptions, including the Manufacturing Exception, operate upon income's status as FBCSI (i.e., when an exception is met, the income is not FBCSI), we should check for the applicability of those exceptions to a

(d)(2) transaction through § 1.954-3(b)(2)(ii)(e). That means, even putting the statutory structure to the side, we must check if the Manufacturing Exception applies here, even though we are within the Branch Rule under (d)(2).

One last regulatory argument suggests we apply the (d)(1) regulatory exceptions to the (d)(2) transaction. Recall that the first part of the (d)(2) manufacturing branch regulations tells us how to determine whether there is a tax rate disparity. As part of that calculation, we allocate to the remainder "income derived by the remainder" that would be FBCSI under (d)(1), but *without applying* (d)(1)'s exceptions. 26 C.F.R. § 1.954-3(b)(1)(ii)(b); *see also id.* § 1.954-3(b)(2)(i). But once we determine that the use of a branch has the same effect as a wholly owned subsidiary, we apply a *different* set of rules, this time from the second part of (d)(2)'s manufacturing branch regulations. *See id.* § 1.954-3(b)(2)(ii). And missing from that set of rules is any requirement that we refrain from applying (d)(1)'s exceptions. Instead, § 1.954-3(b)(2)(ii)(e) says the opposite—that we *should* apply the (d)(1) exceptions. So Treasury knew how to tell us when not to apply the (d)(1) exceptions to a (d)(2) transaction, but it elected to do so only for determining whether a tax rate disparity exists, and not for determining whether a specific transaction generated FBCSI.

That we should filter (d)(2) transaction back through the (d)(1) framework makes sense when we consider why (d)(2) exists in the first place. It's there so that CFCs can't evade (d)(1) by using a branch to avoid a Related-Person Transaction. It makes little sense, then, to treat a CFC *worse* for using a branch than it would be treated under (d)(1). *See* Voce, *supra*

at 349. That's why (d)(2)'s regulations say that if the CFC wouldn't have FBCSI were the branch and remainder separate companies, then it shouldn't have FBCSI under (d)(2). *See* 26 C.F.R. § 1.954-3(b)(2)(ii)(e). So if a transaction wouldn't generate FBCSI under (d)(1) because of the Manufacturing Exception, then neither will it generate FBCSI just because the CFC used a branch. *See id.*

In short, the structure of § 954(d)(2) supports running a branch transaction through the (d)(1) framework, and the regulations—which no one challenges here—tell us *explicitly* to do so. And applying the Manufacturing Exception here means LUX didn't generate taxable FBCSI.

D.

Though the statutory and regulatory language and structure establish that (d)(2) branch transactions run back through the (d)(1) framework, I also note some other support for my position. Tax scholars, for instance, agree not only that (d)(2) transactions filter through (d)(1), but that § 1.954-3(b)(2)(ii)(e) means we apply (d)(1)'s exceptions, including its Manufacturing Exception, to a branch-remainder transaction. Voce, *supra* at 347–48 ("[T]he Branch Rule of section 954(d)(2) is only intended to subject transactions between a CFC and a branch to the same rules that are applicable to transactions between the CFC and a subsidiary under section 954(d)(1), not to create a different or more stringent test for what constitutes FBCSI."); *see also* Laity, *supra* at 145 (noting that "[w]hen computing this additional foreign base company sales income, the U.S. shareholders may use" the (d)(1) exceptions); Dolan, et al., *supra* § 18.06 at *8.

Notably, the IRS agrees with my framework. In Technical Advice Memorandum 8509004 (1984), for instance, the IRS applied the Manufacturing Exception to a branch transaction through § 1.954-3(b)(2)(ii)(e). Citing (e), the IRS noted that "income derived by the branch or the remainder . . . will not be considered foreign base company sales income if such income would not be so considered if it were derived by a separate CFC under like circumstances. Under [the Manufacturing Exception], income derived by the branch . . . would not constitute foreign base company sales income *since the branch manufactured and sold Product Z.*" Technical Advice Memorandum 8509004 (1984) (emphasis added). It did the same in an earlier Private Letter Ruling. *See* Private Letter Ruling 7612101490A (1976) ("The income of NEWCO *** as a manufacturing branch is not subpart F income under section 954(d)(1)(A) . . . because its income is derived from sales of property it manufactures."). And, importantly, it takes the same position in its briefing here. (*See* Appellee Br. at 34–35 & n.14.)

II.

What's the consequence of all this? Whether we place LUX's relevant sales within the (d)(1) or (d)(2) bucket, we need to check whether the Manufacturing Exception applies. To be sure, under (d)(1), LUX made sales to a related person (Whirlpool U.S. and Mexico) *and* probably on behalf of a related person (WIN). So it has a (d)(1) *transaction*. Likewise, under (d)(2), LUX's use of WIN likely had "substantially the same effect" as if WIN were a wholly owned subsidiary of LUX and not a branch. Thus, however we cut it, LUX has a qualifying transaction.

But we still need to check if any exceptions to FBCSI apply. That's the explicit command of § 1.954-

3(b)(2)(ii)(e), and it's the implicit route the statutory and regulatory structure say we should take. Recall that except for federal taxation, WIN is a wholly owned subsidiary of LUX. So for the 1.954-3(b)(2)(ii)(e) inquiry, we can say WIN is a wholly owned subsidiary of LUX and thus a separate corporation. Viewing it that way brings us back under § 954(d)(1) since wholly owned subsidiaries are related to their owner. Under that arrangement, did LUX generate FBCSI? The answer is no, because of the Manufacturing Exception.

The Manufacturing Exception is a regulatory provision. *See* 26 C.F.R. § 1.954-3(a)(4). Under the regulation, "income of a [CFC] derived in connection with the sale of personal property *manufactured, produced, or constructed by such corporation* in whole or in part from personal property which [the CFC] has purchased" is not FBCSI. *Id.* § 1.954-3(a)(4)(i) (emphasis added). A CFC "[is] considered" to have manufactured the personal property it buys and then sells "if the property sold is in effect not the property which it purchased." *Id.* And the property sold is not the property purchased if it "is *substantially transformed* prior to sale." *Id.* § 1.954-3(a)(4)(ii) (emphasis added). The regulation gives a few examples of substantial transformation: wood pulp to paper; steel rods to screws and bolts; and tuna fish to canned fish. *Id.*

All this means that if the property LUX bought "[wa]s substantially transformed" before LUX sold it, then those sales did not generate FBCSI. And I find it hard to believe that substantial transformation didn't occur here. Transforming sheets of metal into functioning household appliances is surely a more

"substantial transformation" than turning steel rods into screws.

The Commissioner's only response to this intuitive conclusion is that LUX itself didn't do the transforming, so it shouldn't qualify for the exception. The Tax Court shared the Commissioner's concern. Though the court recognized that the property LUX bought underwent substantial transformation before its sale, the court waffled over how much LUX monitored or controlled the manufacturing employees' work, which took place in Mexico.

But the Commissioner and Tax Court read language into the regulation that isn't there.[5] The Manufacturing Exception focuses on the *object* being transformed, not the *entity* doing the transforming. Indeed, nothing in the Manufacturing Exception requires the CFC *itself* to have manufactured anything. That's because the Exception creates a fiction as to the identity of the "manufacturer." Remember, FBCSI doesn't include sales income that a CFC earns "in connection with the sale of personal property manufactured . . . by such corporation . . . from personal property which it has purchased." 26 C.F.R. § 1.954-3(a)(4)(i). And "[i]f purchased personal property is substantially transformed prior to sale, the property sold will be treated as having

[5] Notably, the *new* regulations covering FBCSI contain the language the Commissioner tries to read into the old regulations. Now, to take advantage of the Manufacturing Exception, a CFC must perform the manufacturing "through the activities of its employees." 26 C.F.R. § 1.954-3(a)(4). Moreover, a CFC is no longer "treated as having manufactured, produced, or constructed personal property which the corporation sells merely because the property is sold in a different form than the form in which it was purchased." *Id.*

been manufactured . . . by the selling corporation." *Id.* § 1.954-3(a)(4)(ii).

Note the passive language here. A CFC "is treated" as having manufactured the property it sold if the property "is substantially transformed" before sale. This language means "there is no requirement in the statute or regulations that the CFC's own employees or some other dependent service provider furnish the manufacturing services that transform the product." Dolan, et al., US Taxation of International Mergers, Acquisitions & Joint Ventures § 18.06 at *8 (Oct. 2020). All that the regulation requires is that "the property sold is in effect not the property . . . purchased," 26 C.F.R. § 1.954-3(a)(4)(i), such as when the property "is substantially transformed," *id.* § 1.954-3(a)(4)(ii). So "[o]nce the determination is made that property sold is not the same as the property purchased, it is a foregone conclusion that the CFC is the manufacturer." Dolan, *supra* at *8.

That the Exception doesn't require the CFC itself to manufacture the goods becomes clearer when we look at another exception to (d)(1). This is the Component-Part Exception. Under it, a Related-Person Transaction doesn't generate FBCSI "[i]f purchased property is used as a component part of personal property which is sold." 26 C.F.R. § 1.954-3(a)(4)(iii). But before a CFC qualifies for this exception, the regulation requires that "the operations conducted by the selling corporation in connection with the property purchased and sold [be] substantial in nature." *Id.* That Treasury included this requirement for the Component-Part Exception but not for the Manufacturing Exception suggests the omission in the latter was intentional. *Cf. Russello v.*

United States, 464 U.S. 16, 23, 104 S.Ct. 296, 78 L.Ed.2d 17 (1983) ("[W]here Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion." (citations omitted)). So there is no requirement in the Manufacturing Exception that the CFC itself must manufacture the property.

The Manufacturing Exception creates a simple syllogism. FBCSI does not include the income a CFC earns by selling property it earlier purchased if, in between purchase and sale, it "manufactured" that property. And a CFC is considered to have manufactured the property if the property "is substantially transformed prior to sale." Thus, if property has been substantially transformed before its sale, the income a CFC earns through the sale is not FBCSI. And because the property LUX bought—raw materials—was substantially transformed into functioning household appliances before LUX sold it, I believe LUX's sales income qualifies for the Manufacturing Exception.

At the very least, there's a question of fact over whether LUX "manufactured" the appliances. And that should've precluded summary judgment, not only on § 954(d)(1), but also on (d)(2).[6]

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[6] I acknowledge that my proposed resolution of this case depends, in large part, on Treasury's relevant regulations. Whirlpool, as part of its argument here, challenges the validity of those regulations. But because the majority believes that (d)(2) defines FBSCI by its own terms, it doesn't address the regulations. And because I believe that Whirlpool should prevail under the applicable regulations as written, I also leave the validity of the regulations to another day.

III.

This isn't an easy case. But in the end, I believe the statute and its regulations lay out a clear path: Apply the (d)(1) framework and exceptions to the (d)(2) branch transaction. Doing so here means LUX didn't generate FBCSI. Even if we don't want to take it that far, there is, at the very least, a disputed fact over whether LUX qualifies for the Manufacturing Exception. And that should've precluded summary judgment.

For these reasons, I respectfully dissent.

UNITED STATES TAX COURT

WHIRLPOOL FINANCIAL CORPORATION AND CONSOLIDATED SUBSIDIARIES, PETITIONER *v.* COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

WHIRLPOOL INTERNATIONAL HOLDINGS S.A.R.L., F.K.A. MAYTAG CORPORATION AND CONSOLIDATED SUBSIDIARIES, PETITIONER *v.* COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Docket Nos. 13986–17, 13987–17 Filed May 5, 2020
154 T.C. 142

OPINION

LAUBER, *Judge*: Whirlpool Financial Corp. (Whirlpool or petitioner), petitioner at docket No. 13986–17, is a Delaware corporation with its principal place of business in Michigan. Whirlpool and its domestic subsidiaries joined in filing a consolidated Federal income tax return for 2009. Through its domestic and foreign subsidiaries, petitioner engages in the manufacture and distribution of major household appliances, including refrigerators and washing machines, in the United States and abroad.

Whirlpool International Holdings, S.a.r.l. (WIH), petitioner at docket No. 13987–17, is a wholly owned subsidiary of Whirlpool organized under the laws of Luxembourg. When it filed its petition, WIH had its principal place of business in Luxembourg. Before December 31, 2010, WIH was known as Maytag Corp. (Maytag) and was likewise engaged in the manufacture and distribution of household appliances. During 2009 and previously Maytag was

a Delaware corporation with its principal place of business in Iowa.

During 2007–2009 petitioner restructured its Mexican manufacturing operations, driven largely by tax considerations. It organized a new entity in Luxembourg, which was a controlled foreign corporation (CFC) for Federal income tax purposes. Through a branch in Mexico, the Luxembourg CFC took over (at least nominally) the manufacturing operations previously conducted by a subsidiary of petitioner's Mexican CFC. The Luxembourg CFC then sold the finished products to petitioner and its Mexican CFC, which distributed the products for sale to consumers. The Luxembourg CFC, which had one part-time employee, added no appreciable value to, but earned substantial income from, these sales transactions.

The Internal Revenue Service (IRS or respondent) determined that the sales income derived by the Luxembourg CFC constituted foreign base company sales income (FBCSI) under section 954(d) and was thus taxable to petitioner as subpart F income under section 951(a).[1] The IRS accordingly increased petitioner's taxable income for 2009 by $49,964,080, decreasing pro tanto its consolidated net operating loss (NOL) carryback deduction. The reduction in available NOL carry-backs generated a deficiency of $43,720 for Whirlpool for 2005 and a deficiency of $440,742 for Maytag for 2000.

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[1] Unless otherwise indicated, all statutory references are to the Internal Revenue Code in effect for the tax year at issue, and all Rule references are to the Tax Court Rules of Practice and Procedure. We round all monetary amounts to the nearest dollar.

After timely petitioning this Court, petitioners filed a motion for partial summary judgment, contending that the Luxembourg CFC's sales income was not FBCSI under section 954(d)(1) because the appliances it sold were substantially transformed by its Mexican branch from the component parts and raw materials it had purchased. Respondent opposed that motion, contending that genuine disputes of material fact exist as to whether the Luxembourg CFC actually manufactured the products. The parties filed cross-motions for partial summary judgment on the question whether the sales income was FBCSI under section 954(d)(2), the so-called "branch rule."

We agree with respondent that genuine disputes of material fact may exist with respect to the application of subsection (d)(1), and in any event we find it unnecessary to decide that question. That is because we agree with respondent with respect to subsection (d)(2). Whether or not the Luxembourg CFC is regarded as having manufactured the products, its Mexican branch under section 954(d)(2) is treated as a subsidiary of the Luxembourg CFC, and the sales income the latter earned constitutes FBCSI taxable to petitioner as subpart F income. We will accordingly deny both of petitioners' motions and grant respondent's cross-motion to the extent it addresses the FBCSI issue.

Background

The following facts are derived from the pleadings, the parties' motion papers, and the exhibits and declarations attached thereto.

I. *Whirlpool's Mexican Manufacturing Operations*

A. *Structure Before 2007*

Before 2007 petitioner indirectly owned 100% of Whirlpool Mexico, S.A. de C.V. (Whirlpool Mexico), a company organized under Mexican Law. Whirlpool Mexico owned (directly or indirectly) 100% of Commercial Acros S.A. de C.V. (CAW) and of Industrias Acros S.A. de C.V. (IAW), both organized under Mexican law. Whirlpool Mexico and its subsidiaries were then, and are now, treated as CFCs of petitioner for Federal income tax purposes.

CAW was the administrative arm of Whirlpool Mexico. Its employees supplied selling, marketing, finance, accounting, human resources, and other back-office services to its Mexican parent and IAW. It also engaged in activities relating to utility service and repairs for both entities.

IAW was the manufacturing arm of Whirlpool Mexico. IAW owned land, buildings, and equipment and employed workers who manufactured refrigerators, washing machines, and other appliances (collectively, Products). IAW manufactured these Products at two separate plants in Mexico: the Ramos plant and the Horizon plant. The Ramos plant, located in Ramos Arizpe, Coahuila, produced refrigerators; the Horizon plant, located in Apodaca, Nuevo León, produced washing machines. IAW sold these Products to Whirlpool Mexico, which in turn sold the Products to petitioner and unrelated distributors in Mexico.

B. *Revised Structure in 2009*

Beginning in 2007 petitioner undertook a reorganization that put a new structure in place for its Mexican operations as of 2009, the tax year at

issue. On May 31, 2007, petitioner created Whirlpool Overseas Manufacturing, S.a.r.l (WOM), an entity organized under the laws of Luxembourg. On August 1, 2007, petitioner transferred ownership of WOM to Whirlpool Luxembourg S.a.r.l. (Whirlpool Luxembourg), an indirect wholly owned subsidiary of petitioner likewise organized under Luxembourg law. Both entities were CFCs for Federal income tax purposes.

Whirlpool Luxembourg appears to have been a holding company with no employees. WOM had one part-time employee, Nour Eddine Nijar. He performed modest administrative functions, including payment of rent, utilities, and other expenses incurred by the Luxembourg office. He also signed contracts on behalf of WOM and signed checks drawn on its bank account. For the sake of simplicity we will refer to these two Luxembourg entities collectively as Whirlpool Luxembourg.

On June 1, 2007, petitioner caused to be created Whirlpool Internacional, S. de R.L. de C.V. (WIN), a company organized under Mexican law. On August 13, 2007, petitioner caused the ownership of WIN to be transferred to Whirlpool Luxembourg, which thereafter owned virtually all of WIN's stock. WIN was treated as an entity separate from Whirlpool Luxembourg for Mexican and Luxembourg tax purposes. But for Federal income tax purposes WIN made what is commonly called a "check-the-box" election. *See* secs. 301.7701-2(a), 301.7701–3(a), Proced. & Admin. Regs. It thus elected to be treated as a "disregarded entity," i.e., as having no existence separate and distinct from Whirlpool Luxembourg.

After 2007 petitioner continued to own Whirlpool Mexico and (through it) CAW and IAW, all of which

remained CFCs. And IAW continued to own the land and buildings used to manufacture the Products. But on various dates during 2007 and 2008 the following transactions occurred: (1) IAW leased to WIN the land and buildings that housed the Ramos and Horizon manufacturing activities; (2) IAW sold to WIN the spare parts, hand tools, and other items needed to support manufacturing activities at those plants; and (3) IAW sold to Whirlpool Luxembourg all of the machinery, equipment, inventories, furniture, and other assets situated within those plants.

As far as the record reveals, WIN had no employees of its own. High-level employees of IAW and CAW were "seconded" to WIN, including the plant manager, the quality control manager, the materials manager, and the controller of each manufacturing facility. Rank-and-file employees of IAW were "subcontracted" to WIN to perform manufacturing, assembly, packaging, storage, repair, and distribution tasks. And rank-and-file employees of CAW were "subcontracted" to WIN to perform selling, marketing, finance, accounting, human resources, and other back-office tasks. The agreements stated that all of these workers remained employees of IAW and CAW, respectively, which appear to have remained solely responsible for their hiring and firing, wages, social benefits, and employment taxes in Mexico.

In July 2007 WIN and Whirlpool Luxembourg executed a "manufacturing assembly services agreement" with respect to the Ramos plant, and in March 2008 they executed a substantially identical agreement with respect to the Horizon plant. Under these agreements WIN contracted to supply the services necessary to manufacture Products at the

two plants using the workers subcontracted to it from IAW and CAW. Whirlpool Luxembourg agreed to supply the machinery, equipment, and raw materials necessary to manufacture the Products at these plants. The parties concurrently executed a "bailment agreement" whereby Whirlpool Luxemburg (as "bailor") agreed to permit WIN (as "borrower") to use the machinery and equipment, free of charge, for the sole purpose of manufacturing the Products. WIN explicitly acknowledged that all raw materials, work-in-process, and finished goods inventory were owned at all times by Whirlpool Luxembourg. We will refer to these agreements collectively as the "Assembly Agreements."

In August 2007 and March 2008 Whirlpool Luxembourg executed "manufacturing supply agreements" with petitioner and Whirlpool Mexico. Whirlpool Luxemburg thereby agreed to act as a "contract manufacturer" for petitioner and Whirlpool Mexico and to sell them the Products assembled at the Ramos and Horizon plants. These sales were to occur at prices "agreed to by the parties from time to time." The agreements stated that Whirlpool Luxembourg was "deemed to have invoiced the Products at the end of the manufacturing process," with title and risk of loss passing to petitioner and Whirlpool Mexico at that point "regardless of the physical location of the Products and any temporary storage that * * * [Whirlpool Luxembourg] may provide." We will refer to these agreements collectively as the "Supply Agreements."

During 2009 Whirlpool Luxembourg defrayed the cost of purchasing the raw materials needed to manufacture the Products, including rolls of steel, sheets of plastic, chemicals, resin, paint, tubing,

and other component parts. The cost of these inputs appears to have exceeded $500 million. These materials were acquired under blanket purchase orders that set forth the terms applicable to each supplier. The purchase orders specified that invoices were to be sent to Whirlpool Luxembourg at its address in Luxembourg but that all raw materials and supplies were to be delivered directly to the Ramos and Horizon plants.

Petitioner's Mexican manufacturing operations, as restructured in 2009, can be summarized as follows. Whirlpool Luxembourg owned the machinery and equipment used to manufacture the Products, and it purchased and retained title to the raw materials and inventory during the manufacturing process. At the end of the manufacturing process Whirlpool Luxembourg transferred title and risk of loss to petitioner and Whirlpool Mexico.

Whirlpool Luxembourg, having no employees of its own (other than Mr. Nijar), contracted with WIN to supply the necessary manufacturing services. WIN, having no employees or manufacturing plant of its own, leased the Ramos and Horizon plants from IAW and arranged to have IAW's and CAW's employees seconded or subcontracted to it. IAW's workers assembled the Products, and CAW's workers supplied the necessary accounting, repair, and back-office services. During 2009 the Ramos plant produced almost one million refrigerators; the Horizon plant produced more than 500,000 washing machines. About 96% of the Products thus manufactured were sold to petitioner, with the balance to Whirlpool Mexico. From these sales Whirlpool Luxembourg derived gross receipts that exceeded $800 million.

II. *Petitioner's Tax Considerations*

A. *Mexico*

Under the Ley del Impuesto Sobre la Renta (Mexican Income Tax Law or MITL), corporations resident in Mexico were generally taxed during 2009 at a 28% rate. MITL arts. 1(I), 10. Non-Mexican residents that had a permanent establishment (PE) in Mexico were likewise subject to tax at a 28% rate on income attributable to the PE. MITL arts. 1(II), 10.

For many years Mexico has had in place a "maquiladora program," as set forth in the Decree for the Promotion of the Manufacturing, Maquila, and Export Services Industry (IMMEX Decree). This program was designed to incentivize foreign principals to locate manufacturing operations in Mexico. IMMEX Decree art. 1. Under Mexican customs rules, the resident maquiladora company must perform the manufacturing activity; the foreign principal must retain title to the raw materials, component parts, and inventory during the manufacturing process, then take title to and sell the finished goods.

During 2009 Mexico taxed resident maquiladora companies at a 17% rate rather than a 28% rate. By locating its manufacturing operations in Mexico, the foreign principal would ordinarily be considered to have a PE in Mexico (and thereby be subject to the 28% tax rate). *See* MITL arts. 1(II), 10. However, a foreign principal was deemed to have no PE in Mexico—and was thus exempt from Mexican income tax—provided that it and the maquiladora company satisfied specified transfer-pricing requirements. *See* MITL art. 2 ("A nonresident shall not be deemed to

have a permanent establishment in Mexico, deriving from the legal or economic relationship with entities carrying on maquila operations.").

For 2009 WIN qualified as a maquiladora company. It thus paid tax to Mexico at a 17% rate on the income it earned from supplying manufacturing services under its Assembly Agreements with Whirlpool Luxembourg. Correspondingly, Whirlpool Luxembourg took the position that it was a foreign principal considered to have no PE in Mexico, so that it was exempt from Mexican tax on the income it earned under its Supply Agreements with petitioner and Whirlpool Mexico. Whirlpool Luxembourg accordingly did not file a Mexican income tax return.

B. *Luxembourg*

Companies resident in Luxembourg with income exceeding €15,000 were generally taxed during 2009 at a composite rate above 28%. However, under articles 7(2) and 23(1)(A) of the Mexico-Luxembourg tax treaty,[2] all income earned by a Luxembourg company that was attributable to a PE in Mexico was exempt from Luxembourg tax.

For Luxembourg tax purposes, Whirlpool Luxembourg took the position that it had a PE in Mexico by virtue of (1) its ownership of the equipment, raw materials, component parts, supplies, and inventory used in its Mexican manufacturing operations, (2) its use of fixed places of business at the Ramos and Horizon plants, and (3) its sale of the Products in Mexico. Representing that it had "a fixed business facility in Mexico whereby it regularly

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[2] Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, Lux.-Mex., Feb. 7, 2001.

conducts commercial activities in Mexico," Whirlpool Luxembourg solicited and received a ruling from Luxembourg tax authorities that it had a PE in Mexico and that all income earned under its Supply Agreements with petitioner and Whirlpool Mexico was attributable to that PE. Accordingly, Whirlpool Luxembourg paid no tax to Luxembourg on the income it earned from sale of finished Products.

III. *IRS Examination*

On its Federal income tax return for 2009 petitioner took the position that none of the income derived by Whirlpool Luxembourg under its Supply Agreements was subject to tax under subpart F. The IRS commenced an examination of that return and determined that Whirlpool Luxembourg's sale of Products to petitioner and Whirlpool Mexico gave rise to FBCSI of $49,964,080. The IRS included that sum in petitioner's income under sections 954(d) and 951(a).[3]

In March 2017 respondent issued timely notices of deficiency to petitioners reflecting these adjustments and several ancillary and computational adjustments. After timely petitioning this Court, petitioners filed motions for partial summary judgment contending that Whirlpool Luxembourg's sales income was not FBCSI under section 954(d)(1)

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[3] Whirlpool Luxembourg derived income of $45,231,843 from sale of the Products. The difference between that amount and the IRS adjustment appears to be attributable to interest income. If Whirlpool Luxembourg's sales income is determined to be FBCSI, then all of its income would apparently be treated as subpart F income under the "full inclusion" rule. *See* sec. 954(b)(3)(B); sec 1.954–1(b)(1)(ii), Income Tax Regs. (treating 100% of CFC's income as subpart F income where FBCSI exceeds 70% of its total gross income).

because the final Products it sold were substantially transformed by its Mexican branch from the raw materials it had purchased. Respondent opposed that motion, contending that genuine disputes of material fact exist as to whether Whirlpool Luxembourg actually manufactured the products. The parties filed cross-motions for partial summary judgment on the question whether the sales income was FBCSI under section 954(d)(2), the so-called "branch rule." Several rounds of briefing ensued.

Discussion

I. *Summary Judgment*

The purpose of summary judgment is to expedite litigation and avoid costly, unnecessary, and time-consuming trials. *See FPL Grp., Inc. & Subs. v. Commissioner*, 116 T.C. 73, 74 (2001). We may grant partial summary judgment when there is no genuine dispute of material fact and a decision may be rendered as a matter of law. Rule 121(b); *Kroh v. Commissioner*, 98 T.C. 383, 389 (1992). In deciding whether to grant summary judgment, we construe factual materials and inferences drawn from them in the light most favorable to the nonmoving party. *Sundstrand Corp. v. Commissioner*, 98 T.C. 518, 520 (1992), *aff'd*, 17 F.3d 965 (7th Cir. 1994). The nonmoving party may not rest upon the mere allegations or denials in his pleadings but must set forth specific facts showing that there is a genuine dispute for trial. Rule 121(d); *see Sundstrand Corp.*, 98 T.C. at 520.

The sole issue we address at this juncture is whether the income derived by Whirlpool Luxembourg from its Product sales to petitioner and Whirlpool Mexico constituted FBCSI within the

meaning of section 954(d)(1) or (2). The parties have filed cross-motions for partial summary judgment with respect to section 954(d)(2). We find that this latter question may appropriately be adjudicated summarily.[4]

II. *Governing Statutory Structure*

Before 1962 the income of a foreign corporation, even one wholly owned by U.S. shareholders, generally was not subject to current U.S. income tax. Such income was taxed in the United States only when repatriated in the form of a dividend. *See Textron Inc. v. Commissioner*, 117 T.C. 67, 73 (2001). This system incentivized U.S. corporations to shift activities to foreign subsidiaries, particularly to subsidiaries in low-tax jurisdictions. *Ibid.*

Passive and highly mobile income was particularly subject to being shifted abroad, because it could be moved to a shell corporation in a low-tax jurisdiction with little or no impact on the U.S. company's actual business operations. *See Vetco, Inc. & Subs. v. Commissioner*, 95 T.C. 579, 585 (1990) (noting that pre-1962 law "resulted in the use of so-called tax haven countries within which only minimal business operations were carried on"). Congress regarded sales income as one type of highly mobile income. *See* H.R. Rept. No. 87–1447, at 62, 1962–3 C.B. 405, 466 ("The sales income with which your committee is primarily concerned is income of a selling subsidiary * * * which has been separated from manufacturing activities of

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[4] Petitioners allege that the notices of deficiency contained "computational errors." To the extent such uncertainties exist they will be resolved in further proceedings or in computations for entry of decision under Rule 155.

a related corporation merely to obtain a lower rate of tax for the sales income.").

Congress enacted subpart F to inhibit this planning strategy. *See* Revenue Act of 1962, Pub. L. No. 87–834, sec. 12, 76 Stat. at 1006 (adding sections 951–964).[5] Section 951 provides that a U.S. shareholder of a CFC must include in his gross income his pro rata share of the CFC's subpart F income. A U.S. shareholder is defined as a U.S. person owning 10% or more of the voting power of a foreign corporation. Sec. 951(b). A foreign corporation is a CFC if more than 50% of its voting power or stock value is held by U.S. shareholders. Sec. 957(a).

Subpart F income is defined to include (among other things) "foreign base company income." Sec. 952(a)(2). As in effect for 2009, "foreign base company income" included "foreign personal holding company income," e.g., dividends, interest, rents, and royalties. Sec. 954(a)(1), (c). It also included three types of foreign base company income, one of which is FBCSI. *See* sec. 954(a)(2), (3), (5). A taxpayer's FBCSI is determined under section 954(d), reduced by deductions allowable under section 954(b)(5). *See* sec. 954(a)(2).

Gross income constitutes FBCSI if it meets the conditions set forth in section 954(d)(1) or (2). These provisions are aimed at personal property transactions involving related parties. They were

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[5] The provisions discussed in the text were effective for tax years before enactment of the Tax Cuts and Jobs Act of 2017, Pub. L. No. 115–97, sec. 14101 et seq., 131 Stat. at 2189, which had an effective date for foreign corporations with taxable years beginning after December 31, 2017, and applies to tax years of U.S. shareholders in which or with which such tax years of foreign corporations end.

intended to capture, and treat as subpart F income, "income from the purchase and sale of property, without any appreciable value being added to the product by the selling corporation." S. Rept. No. 87–1881, at 84, 1962-3 C.B. 707, 790; *see* 3 Joseph Isenbergh, International Taxation, para. 74.27, at 74,043 (4th ed. 2006) ("Foreign base company sales income—perhaps the quintessential form of Subpart F income— * * * is income that results from channeling sales of goods through a low-tax foreign entity that has no significant economic relation to the sales."). Congress was concerned that such artificial separation of sales income from manufacturing income facilitated evasion both of U.S. and foreign tax:

> Your committee * * * has ended tax deferral for American shareholders in certain situations where the multiplicity of foreign tax systems has been taken advantage of by American-controlled businesses to siphon off sales profits from goods manufactured by related parties * * *. In such cases the separation of the sales function is designed to avoid either U.S. tax or tax imposed by the foreign country. [H.R. Rept. No. 87–1447, *supra* at 58, 1962–3 C.B. at 462.]

Section 954(d)(1) generally provides that, when a CFC earns income in connection with the purchase or sale of personal property in certain transactions involving a "related person," that income will be FBCSI if the property is (A) manufactured outside the country in which the CFC is organized and (B) sold for consumption or use outside that country. Section 954(d)(2), captioned "Certain branch income," prevents a U.S. shareholder from escaping section 954(d)(1) by having its CFC conduct activity through

a branch (as opposed to a subsidiary) outside the CFC's home country. Where the carrying on of activities through a branch "has substantially the same effect" as if the branch were a wholly owned subsidiary, then, "under regulations prescribed by the Secretary," the branch will be treated as a subsidiary of the CFC for purposes of determining FBCSI. Sec. 954(d)(2). As we explained in *Vetco Inc.*, 95 T.C. at 593, "the branch rule was intended to prevent CFC's from avoiding section 954(d)(1) because there would be no transaction with a related person."

As a threshold matter, the parties disagree as to which set of regulations governs these cases. Regulations under section 954 were first promulgated in 1964. *See* T.D. 6734, 1964–1 C.B. 237. Those regulations were revised in 2002, and the revisions were made effective for taxable years of CFCs beginning on or after July 23, 2002. *See* T.D. 9008, 2002–2 C.B. 335.

The Department of the Treasury in 2008 proposed further changes to the regulations. *See* sec. 1.954–3, Proposed Income Tax Regs., 73 Fed. Reg. 10716 (Feb. 28, 2008). Revised regulations and temporary regulations interpreting section 954(d)(1) were published on December 29, 2008. *See* T.D. 9438, 2009–5 I.R.B. 387. Further revisions were made to temporary regulations interpreting section 954(d)(2), and those were published in December 2011. *See* T.D. 9563, 76 Fed. Reg. 78545 (Dec. 19, 2011). We will refer to the regulations published in December 2008 and December 2011 collectively as the "new regulations.[6]

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[6] All citations of the 2002 regulations are to Income Tax Regs.; citations of the new regulations refer to 26 C.F.R.

The revisions incorporated in the new regulations were effective for taxable years of CFCs beginning after June 30, 2009, and for taxable years of U.S. shareholders in which (or with which) such taxable years of such CFCs ended. *See* 26 C.F.R. sec. 1.954–3(c) (2011). However, a taxpayer could elect to apply the new regulations retroactively "with respect to its open taxable years that began prior to July 1, 2009." *Id.* para. (d).

Whirlpool and its Luxembourg subsidiaries are all calendar year taxpayers, and these cases involve their 2009 taxable year. Because their 2009 taxable year began before July 1, 2009, the new regulations would apply here only if petitioners elected to have them apply. Petitioners in their tax filings did not make this election. Accordingly, we will apply the 2002 regulations in these cases.[7]

III. *Taxability Under Section 954(d)(1)*

Section 954(d)(1) applies to income derived by a CFC in connection with four categories of property transactions: (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," and (iv) "the purchase of personal property

[7] Respondent contends that the new regulations should apply because petitioners urged during the IRS examination that their reporting was consistent with the new regulations. But in so contending petitioners simply articulated an argument with which the IRS did not agree. Respondent cites no authority for the pro-position that petitioners thereby bound themselves to regulations that are inapplicable by their terms, *see* 26 C.F.R. sec. 1.954–3(c) (2011), and which petitioners permissibly chose not to have applied.

from any person on behalf of a related person." Commissions, fees, or other profits derived by a CFC from such transactions constitute FBCSI if:

> (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 such foreign country, or, in the case of property purchased on behalf of a related person, is purchased for use, consumption, or disposition outside such foreign country.

Whirlpool Luxembourg was created and organized under the laws of Luxembourg, and all of the Products it sold were manufactured in Mexico and sold for use in Mexico or the United States. Since the Products were manufactured outside Luxembourg and sold for use outside Luxembourg, the conditions stated in subparagraphs (A) and (B) were met. Section 954(d)(1) thus applies if the transactions fell within any of the four categories listed above.

Respondent does not contend that Whirlpool Luxembourg "purchase[d] * * * personal property from a related person." Sec. 954(d)(1). Whirlpool Luxembourg appears to have purchased from unrelated suppliers most or all of the raw materials, components, and supplies used to manufacture the

Products. Thus, the first category of transactions did not exist here.[8]

Whirlpool Luxembourg likewise did not sell personal property "on behalf of a related person." Sec. 954(d)(1). It had a subsidiary in Mexico (WIN) and a distinct PE in Mexico by virtue of owning assets and conducting business activities in Mexico. But WIN was disregarded for Federal tax purposes as an entity separate from Whirlpool Luxembourg. All of Whirlpool Luxembourg's activities in Mexico were thus conducted by a branch. Although Whirlpool Luxembourg derived sales income by selling the Products manufactured by its Mexican branch, that branch was not "a related person." *See* sec. 954(d)(3)(A) (defining a "related person" to include (among other things) a "corporation" that is controlled by the CFC).

The fourth category of transactions consists of "the purchase of personal property from any person on behalf of a related person." Whirlpool Luxembourg purchased raw materials from suppliers on behalf of its Mexican branch. Once again, because the Mexican branch was not "a related person," the fourth category of transactions did not exist here. In any event Whirlpool Luxembourg does not appear to have derived any "profits, commissions, [or] fees," *see* sec. 954(d)(1), from its purchasing activities.

The third category of transactions consists of "the purchase of personal property from any person and its sale to a related person." Whirlpool Luxembourg

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[8] Petitioners indicate that Whirlpool Luxembourg "made de minimis purchases of raw materials and component parts from related parties." Respondent directs no argument to this point, and we do not consider it further.

purchased raw materials and component parts from suppliers. And it made sales to "related person[s]," namely petitioner and Whirlpool Mexico. But the items that it sold were not the same as the items that it purchased. Rather, the raw materials that it purchased were converted into refrigerators and washing machines by a multi-step manufacturing process.

The regulations require further analysis. They set forth what is commonly called the "manufacturing exception," providing that FBCSI does not include income derived by a CFC "in connection with the sale of personal property manufactured, produced, or constructed by such corporation * * * from personal property which it has purchased." Sec. 1.954–3(a)(4)(i), Income Tax Regs. A CFC "will be considered, for purposes of this subparagraph, to have manufactured * * * personal property which it sells if the property sold is in effect not the property which it purchased." *Ibid.* This condition is satisfied (inter alia) if the "purchased personal property is substantially transformed prior to sale." *Id.* subdiv. (ii).

The regulation indicates that "substantial transformation" occurs (for example) if a CFC: (1) purchases wood pulp and converts it into paper, (2) purchases steel rods and transforms them into screws and bolts, or (3) purchases fish from fishing boats and processes the live fish into canned tuna. *Id.* *Examples* (*1*), (*2*), and (*3*). Whirlpool Luxembourg purchased rolls of steel, sheets of plastic, chemicals, resin, paint, tubing, and other raw materials from unrelated suppliers, and those raw materials were manufactured into refrigerators and washing machines at the Ramos and Horizon plants. It seems

clear that these purchased items were "substantially transformed."

While not denying that the raw materials were "substantially transformed," respondent challenges petitioner's submission that this manufacturing transformation was effected "by such corporation," viz., by Whirlpool Luxembourg through its Mexican branch. *See id.* subdiv. (i); S. Rept. No. 87–1881, *supra* at 245, 1962–3 C.B. at 949 (stating that manufacturing exception applies to a CFC "if *the corporation* substantially transforms the parts or materials" (emphasis added)); H.R. Rept. No. 87–1447, *supra* at A94, 1962–3 C.B. at 592 (same). Respondent contends that Whirlpool Luxembourg and WIN did not actually perform (or contribute meaningfully to) any manufacturing operations.

As respondent observes, Whirlpool Luxembourg and WIN collectively had one part-time employee, who lived in Luxembourg and had nothing to do with manufacturing. Despite the interposition of these new entities, little appears to have changed on the ground in Mexico after 2008. The refrigerators and washing machines were manufactured in the same plants, which continued to be owned by IAW. The workers who assembled the Products were the same workers, whose wages, benefits, and taxes were paid by IAW as they had been paid previously. There is no evidence that these workers were aware of any change in their employment status after 2008. Whirlpool Luxembourg stepped in as the nominal manufacturer by arranging to have WIN lease the plants and have all the workers seconded or subcontracted to it.

The statute itself sets no parameters on what a CFC must do to qualify as a "manufacturer." Section

954(d)(1)(A) uses that term only once, stating that FBCSI may arise where the property sold is "manufactured * * * outside the country under the laws of which" the CFC is organized. That condition was met here. And the regulation arguably points in two directions. On the one hand it makes the manufacturing exception available for income derived by a CFC "in connection with the sale of personal property manufactured * * * *by such corporation*." Sec. 1.954–3(a)(4)(i), Income Tax Regs. (emphasis added). On the other hand, the next sentence says that the CFC "*will be considered*, for purposes of this subparagraph, to have manufactured * * * personal property * * * if the property sold is in effect not the property which it purchased." *Ibid.* (emphasis added). That inquiry in turn is governed by the "substantial transformation" test, which respondent agrees was satisfied in these cases.[9]

Respondent urges that the meaning of this regulation was clarified by the new regulations and the 2008 preamble introducing them. The preamble stated the Secretary's view that the manufacturing exception should not apply where "the CFC itself performs little or no part of the manufacture of th[e] property." 73 Fed. Reg. 10718 (Feb. 28, 2008). The Department of the Treasury accordingly issued proposed regulations to "clarify that a CFC qualifies for the manufacturing exception * * * only if the CFC, *acting through its employees*, manufactured the relevant product." *Id.* at 10719 (emphasis added).

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[9] The regulations have an alternative to the "substantial transformation" test where a purchased component constitutes part of the property sold. *See* sec. 1.954–3(a)(4)(iii), Income Tax Regs. That alternative test has no application here.

The new regulations revised the second sentence of paragraph (a)(4)(i) to eliminate the statement that the CFC "will be considered * * * to have manufactured" the product. Instead, the revised regulation provides that the CFC "will have manufactured * * * [the product] only if" the CFC meets specified new requirements "through the activities of its employees" as defined for FICA purposes. *See* 26 C.F.R. sec. 1.954–3(a)(4)(i) (2011) (cross-referencing section 31.3121(d)–1(c), Income Tax Regs. (stating that an individual is an employee if "under the usual common law rules the relationship between him and the person for whom he performs services is the legal relationship of employer and employee")).

The new regulations embody these requirements in a "substantial contribution to manufacturing" test. *See* 26 C.F.R. sec. 1.954–3(a)(4)(iv) (2011). Under this test a CFC will be deemed to have manufactured personal property, even if it does not perform the physical assembly, if it "makes a substantial contribution through the activities of its employees" to the manufacturing process. *Id.* subdiv. (iv)(*a*). This test considers whether workers who qualify as common law employees of the CFC provide such services as "[o]versight and direction," assistance with "[m]aterial selection, vendor selection, or control of raw materials," management of "risk of loss * * * or efficiency initiatives," performance of "[q]uality control" or "[c]ontrol of manufacturing related logistics," or development of intellectual property used in manufacturing the products. *Id.* subdiv. (iv)(*b*).

Petitioners reply that the new regulations do not, of their own force, apply here. As noted *supra* p. 154,

the new regulations are effective for taxable years of CFCs beginning after June 30, 2009, and to taxable years of U.S. shareholders in which (or with which) such years of such CFCs end. 26 C.F.R. sec. 1.954–3(c) (2011). Whirlpool and its Luxembourg subsidiaries are all calendar year taxpayers, and these cases involve their 2009 taxable year, which began before July 1, 2009. Although taxpayers could choose to apply the new regulations with respect to open tax years, *id.* para. (d), petitioners have not elected to do so. They urge that the new regulations are inapplicable by their terms and have no relevance here because they did not merely clarify the 2002 regulation but rather imposed substantive new requirements.

Putting the new regulations to one side, respondent contends that petitioners' motion for partial summary judgment under section 954(d)(1) should be denied under existing judicial precedent, specifically, *Elec. Arts, Inc. v. Commissioner*, 118 T.C. 226 (2002). In that case we considered former section 936(h)(5)(B), which provided that an electing corporation would not be treated as having a substantial business presence in a U.S. possession unless the products generating the income were "manufactured or produced in the possession *by the electing corporation* within the meaning of subsection (d)(1)(A) of section 954." *See* sec. 936(h)(5)(B) (1986) (flush language) (emphasis added). The taxpayer's subsidiary in Puerto Rico (the electing corporation) leased factory space from an unrelated company, leased employees from that same company, but itself owned the machinery, equipment, raw materials, and components needed to manufacture the products. The question was whether the products, on these facts,

were "manufactured * * * by the electing corporation" within the meaning of section 954(d)(1)(A). *See* sec. 936(h)(5)(B) (2002) (flush language).

We denied the taxpayer's motion for summary judgment on this question. *Elec. Arts, Inc.*, 118 T.C. at 265, 278. On the one hand we emphasized what we called the "basic general rule" of the governing regulation, viz., that the manufacturing exception applies only to income "derived in connection with the sale of *personal property manufactured * * * by such corporation*." *Id.* at 277 (quoting section 1.954–3(a)(4)(i), Income Tax Regs.). The balance of the regulation, we stated, must be read in "the context provided by the general rule, that the property must have been manufactured or produced by the corporation that is the subject of the inquiry." *Ibid.* On the other hand we did not find in section 954 or its legislative history "an absolute requirement that only the activities actually performed by a corporation's employees or officers are to be taken into account in determining whether the corporation manufactured * * * a product" within the meaning of section 954(d)(1)(A). *Elec. Arts, Inc.*, 118 T.C. at 265. Given this uncertainty, we found it "far from clear that all of the material facts have even been presented, let alone that there is not a genuine issue with respect thereto." *Id.* at 278.

Citing *Elec. Arts* and *MedChem (P.R.), Inc. v. Commissioner*, 116 T.C. 308 (2001), *aff'd*, 295 F.3d 118 (1st Cir. 2002), respondent urges that "a robust factual record is necessary to decide whether a corporation is actually engaged in manufacturing." The general structure of the manufacturing operation here appears to have resembled that in *Elec. Arts*. Like the subsidiary in *Elec. Arts*, Whirlpool

Luxembourg leased the plant and borrowed the employees, but it owned the manufacturing equipment, components, and raw materials used to manufacture the Products.

There may be differences, however, regarding the extent to which Whirlpool Luxembourg monitored or controlled the employees' work. In *Elec. Arts* the subsidiary "employed a manager" who directly supervised workers responsible for materials management, work-in-process, and inventory control. *Elec. Arts, Inc.*, 118 T.C. at 236-237. Whirlpool Luxembourg had no employees in Mexico, and WIN had no employees at all. The record is unclear as to whether WIN had officers or directors in Mexico who exercised actual supervision over any aspect of the manufacturing process. The agreements among IAW, CAW, and WIN appear to have given WIN the right to control the employees' work. But respondent urges that this right was illusory because WIN had no managers who could have done this. *See, e.g.*, *Matthews v. Commissioner*, 92 T.C. 351, 361 (1989) (stating that the right of control, or lack of it, supplies the crucial test in determining the nature of a work relationship), *aff'd*, 907 F.2d 1173 (D.C. Cir. 1990). Citing these and other factual uncertainties, respondent contends that genuine disputes of material fact preclude summary judgment on the section 954(d)(1) issue.

We find it unnecessary to decide that question. In the pages that follow we conclude that Whirlpool Luxembourg earned FBCSI under the "branch rule" of section 954(d)(2). Because it is immaterial to our holding whether its sales income would (or would not) be FBCSI under section 954(d)(1) standing alone, we need not address the legal questions that we left open

in *Elec. Arts* or the factual matters that would be implicated in deciding them.

IV. *Taxability Under Section 954(d)(2)*

When enacting subpart F, Congress described FBCSI as "income of a selling subsidiary * * * which has been separated from manufacturing activities of a related corporation merely to obtain a lower rate of tax for the sales income." S. Rept. No. 87–1881, *supra* at 84, 1962-3 C.B. at 790. Section 954(d)(1) enumerates four categories of transactions that Congress believed might present this scenario. Each is described as a purchase or sale of property involving a CFC and a "related person."

Congress recognized, however, that a "related person" might not exist if the manufacturing and selling activities were split between a CFC and a branch (as opposed to a subsidiary) of the CFC. Splitting sales income from manufacturing income in this manner was advantageous for CFCs incorporated in countries employing a "territorial" system of taxation, as many European countries did. *See* 3 Isenbergh, *supra*, para. 74.30, at 74,049 ("Branches of CFCs chartered in countries that tax territorially can achieve * * * [separation of sales income from manufacturing income] without any ostensible transaction between related persons."). Under a territorial tax system the CFC often would pay no tax to its home country on income sourced through a branch outside its home country, creating the possibility that the U.S. parent could thus achieve indefinite deferral of both U.S. and foreign tax. Congress therefore backstopped section 954(d)(1) with the "branch rule" set forth in subsection (d)(2).

A. *Branch or Similar Establishment*

The threshold question is whether Whirlpool Luxembourg carried on activities in Mexico "through a branch or similar establishment." Sec. 954(d)(2). For purposes of the parties' cross-motions under section 954(d)(2), respondent assumes arguendo (as do we) that Whirlpool Luxembourg manufactured the Products in Mexico. It conducted these manufacturing activities using assets that it owned in Mexico (machinery, equipment, raw materials, and inventory) and services provided by WIN, which was disregarded as a separate taxable entity.

Petitioner does not dispute that Whirlpool Luxembourg did business in Mexico "through a branch or similar establishment," and it would be difficult to contend otherwise. *See* sec. 954(d)(2). A "branch" is not a special form of arrangement attended by particular formalities. " 'Branch' is just a term describing the conduct of a trade or business [by a corporation] directly, rather than through a separate entity." 3 Isenbergh, *supra*, para. 74.33.3, at 74,065. Because WIN elected to be disregarded as a separate entity, it is treated for Federal tax purposes as a branch.[10]

Although Whirlpool Luxembourg had no employees in Mexico, it owned assets in Mexico, acted as a "contract manufacturer" in Mexico, and sold to related parties the Products that it manufactured in Mexico. Its presence in Mexico necessarily took

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[10] By contrast, we have held that another corporation cannot be treated as a "branch" of a CFC if that other corporation is an entity separate and distinct from the CFC for Federal income tax purposes. *See Vetco, Inc.*, 95 T.C. at 589–590; *Ashland Oil, Inc. v. Commissioner*, 95 T.C. 348, 360 (1990).

the form of a branch or division of itself. Indeed, it represented to Luxembourg tax authorities (and received from them a ruling) that it had a "permanent establishment" in Mexico. The conclusion is thus inescapable that Whirlpool Luxembourg carried on activities in Mexico "through a branch or similar establishment."

B. *The Statutory Text*

In analyzing the branch rule we begin with the text of section 954(d)(2). It provides:

> Certain branch income.—For purposes of determining foreign base company sales income in situations in which the carrying on of activities by a * * * [CFC] through a branch or similar establishment outside the country of incorporation of the * * * [CFC] has substantially the same effect as if such branch or similar establishment were a wholly owned subsidiary corporation deriving such income, under regulations prescribed by the Secretary the income attributable to the carrying on of such activities by such branch or similar establishment shall be treated as income derived by a wholly owned subsidiary of the * * * [CFC] and shall constitute foreign base company sales income of the * * * [CFC].

This lengthy sentence has two parts. The first answers the question: "When does this section apply?" The second answers the question: "What is the result when this section applies?" Put another way, section 954(d)(2) begins by setting preconditions that must exist before the statute is triggered, then specifies the consequences when those preconditions are met.

Section 954(d)(2) establishes two preconditions for its application: (1) the CFC must be carrying on activities "through a branch or similar establishment" outside its country of incorporation, and (2) the conduct of activities in this manner must have "substantially the same effect" as if the branch were a wholly owned subsidiary of the CFC. The first precondition is clearly met here: Whirlpool Luxembourg was incorporated in Luxemburg, and it carried on its manufacturing activities "through a branch or similar establishment" in Mexico.

The statute then asks whether this mode of operation has "substantially the same effect" as if the Mexican branch were a wholly owned subsidiary of Whirlpool Luxembourg. Under U.S. tax rules in effect when Congress enacted subpart F, a key difference between a branch and a subsidiary was the manner in which the income they earned was reported by their respective owners (viz., the branch's home office and the subsidiary's parent). *See generally United States v. Goodyear Tire & Rubber Co.*, 493 U.S. 132, 140–141 (1989). Except where a consolidated return was filed, a U.S. parent corporation typically reported, not the entire income earned by a subsidiary, but only the distributions it received from the subsidiary during the taxable year. By contrast, 100% of the income earned by a branch (wherever located) was currently taxable to and reported by the U.S. corporation that served as its home office.

Section 954(d)(2) reflects Congress' recognition that, under other countries' tax rules, income earned by the branch of a CFC might be treated differently than under U.S. tax rules, with the result that the branch's income would not be currently taxable in the CFC's country of incorporation. This outcome was

particularly likely where the CFC's country of incorporation employed a "territorial" system of taxation. *See supra* p. 162. Congress was determined to end tax deferral where "the multiplicity of foreign tax systems has been taken advantage of by American-controlled businesses to siphon off sales profits from goods manufactured by related parties," thus "avoid[ing] either U.S. tax or tax imposed by the foreign county." H.R. Rept. No. 87–1447, *supra* at 58, 1962–3 C.B. at 462.

Where a CFC was chartered in a country that employed a territorial tax system, the CFC's conduct of business through a branch outside of the CFC's home country and earning only income sourced there could have "substantially the same effect" as if that income were earned by a subsidiary under U.S. tax rules. That is because, in either case, the income typically would not be currently taxable to its ultimate owner (viz., the branch's home office or the subsidiary's parent). As the Senate Finance Committee explained, the branch rule was intended to capture sales income where "the combined effect of the tax treatment accorded the branch, by the [CFC's] country of incorporation * * * and the country of operation of the branch, is to treat the branch substantially the same as if it were a subsidiary corporation organized in the country in which it carries on its trade or business." S. Rept. No. 87–1881, *supra* at 84, 1962–3 C.B. at 790.

Once the preconditions discussed above are found to exist, the second part of section 954(d)(2) prescribes the results that follow. The prescribed results are that "the income attributable to the carrying on of such activities by such branch or similar establishment shall be treated as income derived by a

wholly owned subsidiary of the * * * [CFC]" and that such income "shall constitute foreign base company sales income of the * * * [CFC]." The Secretary was authorized to issue regulations implementing these results.

Petitioners' operations in Mexico and Luxembourg, as restructured during 2007 and 2008, clearly fall within the scope of section 954(d)(2). The statute's first precondition is met because Whirlpool Luxembourg carried on activities "through a branch or similar establishment outside * * * [its] country of incorporation." And the statute's second precondition is met because this manner of operation had "substantially the same effect," for U.S. tax purposes, as if the Mexican branch were a wholly owned subsidiary of Whirlpool Luxembourg.

As petitioners admit, Luxemburg in 2009 employed a territorial system of taxation. Luxembourg exempted from current taxation income earned by a foreign branch of a Luxembourg corporation, provided that the branch constituted a PE of the Luxembourg corporation in that foreign country. Whirlpool Luxembourg represented to Luxembourg tax authorities that it had a PE in Mexico. And it received a ruling from them that it had a PE in Mexico and that all income earned under its Supply Agreements with petitioner and Whirlpool Mexico was attributable to that PE. Whirlpool Luxembourg thus paid no tax to Luxembourg on its sales income.

Under the maquiladora regime, Mexico taxed WIN on the income it earned from supplying manufacturing services to Whirlpool Luxemburg. But Mexico treated Whirlpool Luxembourg as a "foreign principal" that was deemed to have no PE in

Mexico. Whirlpool Luxembourg thus paid no tax to Mexico on its sales income.

By carrying on its activities "through a branch or similar establishment" in Mexico, Whirlpool Luxembourg avoided any current taxation of its sales income. It thus achieved "substantially the same effect"—deferral of tax on its sales income—that it would have achieved under U.S. tax rules if its Mexican branch were a wholly owned subsidiary deriving such income. That is precisely the situation that the statute covers.

The statute's preconditions having been met, the second part of section 954(d)(2) specifies the prescribed tax treatment. The sales income attributable to the carrying on of activities through Whirlpool Luxembourg's Mexican branch "shall be treated as income derived by a wholly owned subsidiary" of Whirlpool Luxembourg. And the sales income thus derived "shall constitute foreign base company sales income of the * * * [CFC]." Sec. 954(d)(2). In short, even without the refinements supplied by the regulations implementing section 954(d)(2), the bare text of the statute, literally read, indicates that Whirlpool Luxembourg's sales income is FBCSI that must be included in petitioners' income under subpart F.

C. *The Secretary's Regulations*

As directed by Congress, the Secretary promulgated regulations governing application of the branch rule. *See* sec. 1.954–3(b), Income Tax Regs. They create parallel sets of rules for "sales or purchase branches" and "manufacturing branches." *See id.* subpara. (1)(i) and (ii). Where (as here) a CFC carries on manufacturing activities through a branch

outside the CFC's country of incorporation, the CFC and its branch will be treated as separate corporations for purposes of determining FBCSI if "the use of the branch * * * for such activities with respect to personal property * * * sold by or through the remainder of the * * * [CFC] has substantially the same tax effect as if the branch * * * were a wholly owned subsidiary" of the CFC. *Id.* subdiv. (ii)(*a*).

To determine whether the tax effect is "substantially the same," the regulations dictate a two-phase inquiry. The first phase requires that we allocate income between the branch and "the remainder" of the CFC. *Id.* subdiv. (ii)(*b*). The second phase requires that we compare actual and hypothetical "effective rates of tax" applicable to the sales income allocated to the remainder. *Ibid.*

1. *Allocation*

Because Whirlpool Luxembourg and WIN were separate corporations (although not distinct tax entities for U.S. tax purposes), their activities and income can be separated quite easily. WIN leased the Ramos and Horizon plants from IAW, and it derived income (computed on a cost-plus basis) for supplying the manufacturing services needed to assemble the Products at those plants. The manufacturing income WIN earned was treated as having been earned at arm's length under Mexican transfer pricing rules. Although Whirlpool Luxembourg owned the machinery and equipment, it allowed WIN to use that machinery and equipment free of charge under the "bailment agreement." *See supra* p. 147. The proper allocation of income between the branch and "the remainder" thus seems intuitively clear: The Mexican branch earned all of the manufacturing

income, and all of the sales income was allocable to "the remainder."

The regulations yield the same result by a more complicated process, which is designed to ensure that only sales income (and not manufacturing income) is allocated to "the remainder" in this scenario. *See* 3 Isenbergh, *supra*, para. 74.31, at 74,053 (noting that the income allocated to the remainder "is only that attributable to the sales component of gain from the combined production and sales of a branch"). While the objective seems clear, the process is somewhat tedious.

The regulation requires that we allocate to the remainder of Whirlpool Luxembourg "only that income derived by the remainder * * * which, when the special rules of subparagraph (2)(i) of this paragraph are applied," would be FBCSI under the general rules of section 954(d)(1). *See* sec. 1.954-3(b)(1)(ii)(*b*), Income Tax Regs. (cross-referencing paragraph (a)). Subparagraph (2)(i) has five special rules but only two are applicable to the allocation phase. First, the Mexican branch is treated as a wholly owned subsidiary of Whirlpool Luxembourg (the remainder) and is deemed to be incorporated in Mexico. *Id.* subpara. (2)(i)(*a*).

Second, because the branch is a manufacturing branch, the selling activities performed through Whirlpool Luxembourg "shall be treated as performed on behalf of the branch." *Id.* subdiv. (i)(*c*). Because the branch for this purpose is deemed a separate corporation and thus a "related person," the sales income derived by Whirlpool Luxembourg is "derived in connection with * * * the sale of personal property * * * on behalf of a related person." Sec. 954(d)(1); sec. 1.954-3(a)(1)(i), Income Tax Regs. In short, because

all of the remainder's income would be FBCSI under the general rules of section 954(d)(1), all of the non-manufacturing income is allocated to it.

2. *Comparison of Tax Rates*

The regulation next mandates a comparison of tax rates. In effect, it asks whether the sales income allocated to Whirlpool Luxembourg (in phase one above) was taxed during 2009 at an appreciably lower tax rate than the rate at which Mexico would have taxed that income. The text is again quite dense, and the relevant sentence is not one that Ernest Hemingway would have written. It states that the use of a branch will be considered to have "substantially the same tax effect" as the use of a subsidiary corporation

> if income allocated to the remainder of the * * * [CFC] is, by statute, treaty obligation, or otherwise, taxed in the year when earned at an effective rate of tax that is less than 90 percent of, and at least 5 percentage points less than, the effective rate of tax which would apply to such income under the laws of the country in which the branch or similar establishment is located, if, under the laws of such country, the entire income of the * * * [CFC] were considered derived by such corporation from sources within such country from doing business through a permanent establishment therein, received in such country, and allocable to such permanent establishment, and the corporation were created or organized under the laws of, and managed and controlled in, such country. [Sec. 1.954-3(b)(1)(ii)(*b*), Income Tax Regs.]

In making this tax rate comparison, we are instructed to take into account "only the income, war profits, excess profits, or similar tax laws (or the absence of such laws) of the countries involved." *Id.* subpara. (2)(i)(*e*).

The sales income that the regulation allocates to the remainder of Whirlpool Luxembourg was taxed during 2009 at a rate of 0%. Although Mexico imposed a 17% tax rate on WIN's manufacturing income, Whirlpool Luxembourg, as a foreign principal under the maquiladora decree, was deemed to have no PE in Mexico and was thus immune from Mexican tax. But for Luxembourg tax purposes Whirlpool Luxembourg was deemed *to have* a PE in Mexico, and it was thus immune from Luxembourg tax. Whirlpool Luxembourg accordingly paid no tax to either jurisdiction in 2009.

The regulation requires that we compare this 0% actual rate of tax to the effective rate of tax that would apply to the sales income, under Mexican law, if Whirlpool Luxembourg were a Mexican corporation doing business in Mexico through a PE in Mexico and deriving all of its income from Mexican sources allocable to that PE. *See id.* subpara. (1)(ii)(*b*). Under these assumptions Whirlpool Luxembourg would not have qualified for the 17% reduced rate of tax applicable to maquiladora companies. Its income would therefore have been taxed by Mexico at a 28% rate, the rate applicable to Mexican corporations generally. *See supra* p. 148.

The 0% rate at which Whirlpool Luxembourg's allocated sales income was actually taxed during 2009 is less than 90% of, and is more than 5 percentage points below, the 28% rate at which its income would have been taxed by Mexico on the

assumptions mandated by the regulation. Whirlpool Luxembourg's use of a branch in Mexico is thus considered to have had "substantially the same tax effect as if the branch * * * were a wholly owned subsidiary corporation." Sec. 1.954-3(b)(1)(ii)(*b*), Income Tax Regs.

3. *Status of Income as FBCSI*

Having determined that Whirlpool Luxembourg ("the remainder") and its Mexican branch are to be treated as separate corporations, we are directed to apply certain rules to determine whether "the remainder * * * has foreign base company sales income." *See id.* subpara. (2)(ii). First, the Mexican branch is treated as a wholly owned subsidiary of Whirlpool Luxembourg and is deemed to be incorporated in Mexico. *Id.* subdiv. (ii)(*a*). Second, selling activities performed by Whirlpool Luxembourg "with respect to the personal property manufactured * * * by or through the branch * * * shall be treated as performed on behalf of the branch." *Id.* subdiv. (ii)(*c*). The regulation includes other special rules—e.g., preventing items from being included twice in gross income—that do not affect the outcome here. *See id.* subdiv. (ii)(*b*), (*d*), (*e*), (*f*).

Together these rules produce a foreseeable outcome. Under section 954(d)(2) the Mexican branch is deemed to be a wholly owned subsidiary of Whirlpool Luxembourg, and Whirlpool Luxembourg is deemed to have sold the Products to petitioner and Whirlpool Mexico on behalf of its deemed Mexican subsidiary. Whirlpool Luxembourg thus derived income in connection with "the sale of personal property to any person on behalf of a related person." Sec. 954(d)(1). The Products were manufactured outside Luxembourg and were sold "for use * * * [or]

consumption" outside Luxembourg. *Id.* subparas. (A) and (B); sec. 1.954–3(a)(2) and (3), Income Tax Regs. The sales income derived by Whirlpool Luxembourg thus constituted FBCSI under section 954(d) and was taxable to petitioner as subpart F income under section 951(a).[11]

This conclusion comports with the overall statutory structure and with Congress' purpose in enacting subpart F. The sales income with which Congress was concerned was "income of a selling subsidiary * * * which has been separated from manufacturing activities of a related corporation merely to obtain a lower rate of tax for the sales income." H.R. Rept. No. 87–1447, *supra* at 62, 1962–3 C.B. at 466. That is precisely the objective that Whirlpool aimed to achieve here.

Whirlpool's manufacturing activity in Mexico was conducted after 2008 exactly as it had been conducted before 2009, using the same plants, workers, and equipment. But the sales income was carved off into a Luxembourg affiliate that enjoyed a 0% rate of tax.

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[11] An example in the regulations reaches a similar conclusion after positing facts substantially identical to those here. *See* sec. 1.954–3(b)(4), *Example* (*2*), Income Tax Regs. (concluding that income derived by a manufacturing branch was not FBCSI but that sales income derived by the remainder of the CFC was FBCSI under the branch rule because it was derived "from the sale of personal property on behalf of [the] branch"). Petitioners contend that the remainder should be deemed to make sales "on behalf of" its branch only if the remainder functions as a sales agent, earning commissions without taking title to the property. But section 954(d)(1) defines FBCSI as "income (whether in the form of profits, commissions, fees, or otherwise)." And the regulations (including the example referenced above) make clear that FBCSI is not limited to commission income.

The Luxembourg sales affiliate epitomizes the abuse at which Congress aimed: The selling corporation derived "income from the * * * sale of property, without any appreciable value being added to the product by the selling corporation." S. Rept. No. 87–1881, *supra* at 84, 1962–3 C.B. at 790. If Whirlpool Luxembourg had conducted its manufacturing operations in Mexico through a separate entity, its sales income would plainly have been FBCSI under section 954(d)(1). Section 954(d)(2) prevents petitioners from avoiding this result by arranging to conduct those operations through a branch.

D. *Petitioners' Arguments*

1. *Whirlpool Luxembourg's Sales Activities*

Petitioners first contend, in effect, that Whirlpool Luxembourg had no substance. The manufacturing branch rule operates to characterize income as FBCSI where "purchasing or selling activities [are] performed by or through the remainder of the * * * [CFC] with respect to the personal property manufactured" by the branch. Sec. 1.954–3(b)(2)(i)(*c*), Income Tax Regs. Because Whirlpool Luxembourg ("the remainder") had only one part-time employee, petitioners urge that "the remainder performs no sales or purchasing activities" and hence that "the manufacturing branch rule is inapplicable."

This argument strikes us as facetious. The essence of petitioners' position under section 954(d)(1) is that Whirlpool Luxembourg was a real company engaged in real business activities. It owned all of the manufacturing equipment and purchased the raw materials used to manufacture the Products. It took title to the finished Products, as it was required to do in order to comply with Mexico's maquiladora decree.

A transfer pricing study commissioned by WIN represented to the Mexican Government that "no sales effort is made" by WIN and that "all responsibility for the distribution, marketing, and sale of [the] products" fell to Whirlpool Luxembourg. In seeking partial summary judgment under section 954(d)(1), petitioners asserted that Whirlpool Luxembourg's operations "[w]ithout question * * * were substantial" and that Whirlpool Luxembourg must be treated "as having sold a manufactured product." Asserting that Whirlpool Luxembourg's activities were insubstantial for purposes of seeking partial summary judgment under section 954(d)(2) is a classic example of an attempt to have one's cake and eat it too.

Under Mexican law, WIN as a maquiladora company was required to engage in manufacturing and *only* in manufacturing. Of necessity, therefore, Whirlpool Luxembourg derived all of the income from selling the Products. As WIN's foreign principal, moreover, Whirlpool Luxembourg was able to avoid having a taxable PE in Mexico for Mexican tax purposes only if its transactions with WIN satisfied Mexican transfer pricing requirements. That being so, it ill behooves petitioners to urge that Whirlpool Luxembourg "performs no sales activities."

The statute defines FBCSI to include income "derived in connection with the * * * sale of personal property to any person on behalf of a related person." Sec. 954(d)(1). After application of the branch rule, Whirlpool Luxembourg unquestionably derived such income: It held legal title to the Products and it sold $800 million worth of Products to petitioner and Whirlpool Mexico during 2009. Making sales is necessarily a "sales activity."

Since Whirlpool Luxembourg sold all of the Products to a pair of related parties, it did not need to expend significant effort to make these sales. But neither the statute nor the regulations require that a CFC engage in substantial marketing efforts. Quite the contrary: Congress presumed that the CFC's marketing efforts would typically be insubstantial, since it described FBCSI as arising "from the * * * sale of property, without any appreciable value being added to the product by the selling corporation." S. Rept. No. 87–1881, *supra* at 84, 1962–3 C.B. at 790.

When reorganizing its Mexican manufacturing operations in 2008, Whirlpool chose its corporate structure. Under that structure Whirlpool Luxembourg was the company that owned the Products and sold the Products. That being so, petitioners cannot plausibly contend that Whirlpool Luxembourg "performed no sales activities." "[W]hile a taxpayer is free to organize his affairs as he chooses, nevertheless, once having done so, he accepts the tax consequences of his choice." *Commissioner v. Nat'l Alfalfa Dehydrating & Milling Co.*, 417 U.S. 134, 149 (1974).[12]

2. *Tax Rate Disparity*

Petitioners next contend that no tax rate disparity exists when we compare the actual and hypothetical tax rates applicable to Whirlpool Luxembourg's sales

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[12] In support of their argument petitioners cite IRS Tech. Adv. Mem. (TAM) 8509004 (Nov. 23, 1984). Such memoranda have no precedential force. *See* sec. 6110(k)(3). In any event the TAM petitioners cite is distinguishable: There (unlike here) the remainder of the CFC was treated as having made no sales because "[t]itle to, and ownership of, all work in process, as well as finished goods, was clearly in the branch."

income. *See* sec. 1.954-3(b)(1)(ii)(*b*), Income Tax Regs. Petitioners assert that the effective Luxembourg tax rate should be 24.2% rather than 0%. And they assert that the hypothetical Mexican tax rate should be 0.56% rather than 28%.

Petitioners derive a hypothetical Mexican rate of 0.56% by assuming that, if all of Whirlpool Luxembourg's income were taxed by Mexico, Whirlpool Luxembourg would still qualify for Mexican tax incentives under the maquiladora program. That assumption is false. Under the tax rate disparity test set forth in the regulations, we are required to assume that Whirlpool Luxembourg derives 100% of its income from sources in Mexico "from doing business through a permanent establishment therein," with all of its income being "allocable to such permanent establishment." *See ibid.* If Whirlpool Luxembourg had a PE in Mexico and all of its income were allocable to that PE, it would be taxed in Mexico at a rate of 28%. *See supra* p. 148.

If a 28% hypothetical rate applies in Mexico, petitioners urge that the effective tax rate in Luxembourg should be deemed to be 24.2%, which is not "5 percentage points less than" 28%. *See* sec. 1.954–3(b)(1)(ii)(*b*), Income Tax Regs. Petitioners derive a 24.2% tax rate by noting that Whirlpool Luxembourg in 2009 paid Luxembourg tax of €6,566 on income (mostly interest income) of €27,135.

This argument ignores the instructions of the regulations. They require that we first allocate sales income to Whirlpool Luxembourg as "the remainder" of the CFC, and then consider the rate at which the "income allocated to the remainder * * * is, by statute, treaty obligation, or otherwise, taxed in the year when

earned." *See ibid.* In other words we do not look to the rate of tax that Whirlpool Luxembourg paid on its miscellaneous other income; the regulation directs we look to the worldwide rate of tax that was actually imposed on its allocated sales income.

That rate was 0%. Whirlpool Luxembourg paid no tax to Mexico on the sales income because it was deemed, under the maquiladora decree, to have no PE in Mexico. And Whirlpool Luxembourg paid no tax to Luxembourg on the sales income because it was deemed, under Luxembourg law, *to have* a PE in Mexico. Whirlpool Luxembourg indisputably paid no tax to either jurisdiction on its sales income.

3. *Same Country Exception*

Petitioners contend that our analysis should center on WIN (rather than on Whirlpool Luxembourg) and that sales of the Products manufactured by WIN fit within the "same country exception." *See id.* para. (a)(2). This exception applies where "property is manufactured * * * in the country under the laws of which the * * * [CFC] which purchases and sells the property * * * is created or organized." *Ibid.*

Whirlpool Luxembourg purchased the raw materials and component parts used to manufacture the Products, and it held title to the work-in-process inventory throughout the manufacturing process. It derived sales income by selling the finished Products to petitioner and Whirlpool Mexico. Under Mexican law, as well as under the branch rule, WIN supplied manufacturing services and thus derived manufacturing income; it derived no sales income. Whirlpool Luxembourg was thus the CFC "which purchases and sells the property." *Ibid.* Whirlpool

Luxembourg was organized in Luxembourg, but the Products were manufactured in Mexico. The "same country manufacturing exception" thus has no application to Whirlpool Luxembourg's activities or income.

4. *Validity of the Regulations*

Finally, as an alternative to the arguments addressed above, petitioners contend that the regulations are invalid as applied to the structure Whirlpool created. In petitioners' view, section 954(d)(2) applies only in situations where a CFC conducts manufacturing activities and has a "sales branch," as opposed to the converse situation (such as this) where the CFC conducts sales activities and has a "manufacturing branch." Petitioners urge that the "manufacturing branch rule of Treas. Reg. § 1.954–3(b)(1)(ii) is invalid, as it exceeds the scope of authority granted by the plain language of section 954(d)(2)."

In addressing petitioners' challenge we apply the familiar two-step test of *Chevron, U.S.A., Inc. v. Nat. Res. Def. Council, Inc.*, 467 U.S. 837 (1984). First we ask "whether Congress has directly spoken to the precise question at issue." *Id.* at 842; *see City of Arlington v. FCC*, 569 U.S. 290, 296 (2013). "If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress." *Chevron*, 467 U.S. at 842–843. In determining whether the intent of Congress is clear, we consider "the language [of the statute] itself, the specific context in which that language is used, and the broader context of the statute as a whole." *Robinson v. Shell Oil Co.*, 519 U.S. 337, 341 (1997). If the statute is silent or ambiguous with respect to the

question at issue, step two of *Chevron* requires the court to give deference to the agency's construction, so long as it is permissible and not "arbitrary, capricious, or manifestly contrary to the statute." *Chevron*, 467 U.S. at 844; *see United States v. Mead Corp.*, 533 U.S. 218, 227 (2001).

a. *Chevron Step One*

The text of section 954(d)(2) consists of one lengthy sentence. The opening clauses, which resemble a preamble, set forth the preconditions for application of this provision. They say that subsection (d)(2) applies for purposes of determining FBCSI in situations where the carrying on of activities by a CFC through a branch outside its country of incorporation "has substantially the same effect as if such branch * * * were a wholly owned subsidiary corporation deriving such income." This preamble does not use the words "manufacturing" or "sales" and makes no reference to the type of activity conducted by the CFC or the branch.

The next clause states the general rule that applies when the conditions set forth in the preamble are met, namely: "[U]nder regulations prescribed by the Secretary the income attributable to the carrying on of such activities of such branch * * * shall be treated as income derived by a wholly owned subsidiary of the * * * [CFC]." This clause likewise does not use the words "manufacturing" or "sales" and makes no reference to the type of activity conducted by the CFC or the branch. Up to this point, therefore, the statute would appear to envision regulations applicable to any kind of branch.

Petitioners hitch their wagon to the final clause of subsection (d)(2)—"and shall constitute foreign base

company sales income of the * * * [CFC]." The subject of the verb "shall constitute" is "income attributable to the carrying on of such activities of such branch." In the case of a sales branch the income attributable to its activities would typically be sales income, which might well constitute FBCSI. But in the case of a manufacturing branch the income attributable to its activities would commonly be manufacturing income, which normally would not constitute FBCSI. Concluding for this reason that Congress must have been thinking of sales branches when it drafted the statute, petitioners interpret subsection (d)(2) to authorize the Secretary to prescribe regulations dealing only with sales branches.

This final clause of subsection (d)(2), however, is a double-edged sword for petitioners. If the final clause is read literally, the branch's income *automatically* constitutes FBCSI once the branch is treated as a subsidiary. Petitioners would lose under the statute's bare text if it is interpreted this way. *See supra* pp. 163–166.

Perhaps conscious of this problem, petitioners elsewhere submit that the final clause of subsection (d)(2) should not be read literally. Treating the branch as a subsidiary, they urge, "does not * * * give rise to FBCSI in and of itself." Rather, petitioners interpret subsection (d)(2) as requiring that "the FBCSI provisions under section 954(d)(1) must be applied to the income deemed to be derived by the * * * Branch and the Remainder as if each were a separate corporation."

This latter interpretation of the statute is by no means implausible. Sub-section (d)(2) begins with the phrase, "For purposes of determining foreign base company sales income," a term that is defined in

subsection (d)(1). On this interpretation, subsection (d)(2) does not create a self-sufficient test for determining that income constitutes FBCSI. Rather, it directs that we change the assumptions employed in applying subsection (d)(1), so that the branch is deemed a subsidiary—and hence a "related party"—for purposes of determining whether any category of transaction specified in subsection (d)(1) exists.

Treating the branch as a subsidiary, in other words, does not seem to be a sufficient condition for determining that FBCSI has been earned. Rather, having adopted that treatment, we must refer back to subsection (d)(1) and ascertain whether a specified category of sales transaction exists. And we must determine, on the facts of the particular case, whether the property was manufactured and sold for use outside the CFC's country of incorporation, as subsection (d)(1)(A) and (B) require.

In short, when stating that the branch's income shall be deemed derived by a subsidiary "and shall constitute FBCSI," Congress may have meant that the branch's income shall be deemed derived by a subsidiary "for purposes of determining FBCSI under subsection (d)(1)." If that were the intended meaning, section 954(d)(2) would plausibly envision regulations dealing with any sort of branch. For that reason it appears to us that the statute is ambiguous.

If, as petitioners contend, the statute is not ambiguous with respect to distinguishing manufacturing and sales branches, we think it is silent on the question at issue. Construed as petitioners wish, subsection (d)(2) only directs the Secretary to prescribe regulations addressing sales branches. But there is nothing in the statute that *prevents* the Secretary from prescribing regulations

that also address manufacturing branches. Section 954(d)(2) simply does not contain the negative pregnant that petitioners seek to read into it.

Section 7805(a) authorizes the Secretary to "prescribe all needful rules and regulations for the enforcement of this title, including all rules and regulations as may be necessary by reason of any alteration of law in relation to internal revenue." In 1962 Congress altered the tax law by enacting subpart F. Section 7805(a) thus authorized the Secretary to prescribe regulations addressing the treatment of manufacturing branches for subpart F purposes, even if section 954(d)(2) did not direct him to do so. Thus, whether we treat the statute as ambiguous or silent on the matter, the question is whether the manufacturing branch regulations are valid under *Chevron* step two.

b. *Chevron Step Two*

Under step two we must evaluate whether the regulations are a "reasonable interpretation" of the statute. *Chevron*, 467 U.S. at 844. We will give deference to the agency's construction unless it is "arbitrary, capricious, or manifestly contrary to the statute." *See id.* at 844. We have no difficulty concluding that the manufacturing branch regulations pass muster under this test.

The legislative history of subpart F leaves no doubt about Congress' intent in enacting the foreign base company provisions. Section 954(d) was intended to capture sales income that has been artificially separated from the manufacturing activities of a related entity. Congress determined that U.S. taxpayers had been "siphon[ing] off sales profits from goods manufactured by related parties"

and that this "separation of the sales function [wa]s designed to avoid either U.S. tax or tax imposed by a foreign country." H.R. Rept. No. 87–1447, *supra* at 58, 1962–2 C.B. at 462. Congress stated that it was "primarily concerned" with "income of a selling subsidiary * * * which has been separated from manufacturing activities of a related corporation merely to obtain a lower rate of tax for the sales income." *Id.* at 62, 1962–3 C.B. at 466; S. Rept. No. 98–1881, *supra* at 84, 1962–3 C.B. at 790 (same). Congress described FBCSI as "income from the purchase and sale of property without any appreciable value being added to the product by the selling corporation." H.R. Rept. No. 87–1447, *supra* at 62, 1962–2 C.B. at 466; S. Rept. No. 87–1881, *supra* at 84, 1962–3 C.B. at 790.

Needless to say, an artificial separation of sales income from manufacturing income can be engineered regardless of whether the CFC or its branch makes the sales. If section 954(d)(2) applied only where taxpayers used a "sales branch," the branch rule that Congress enacted as a backstop to subsection (d)(1) would be a dead letter. Taxpayers could easily evade taxation simply by switching the functions around, placing the sales activities in the CFC rather than in the branch. We have no doubt that Congress would have regarded this as an absurd result.

The Secretary took reasonable steps to avoid this result by prescribing regulations that deal with both scenarios. The manufacturing branch rules and the sales branch rules are mirror images of each other. They work to address in comprehensive fashion the precise problem that Congress identified, viz., the artificial separation of sales income from manufacturing income, in a scenario where the

separation is accomplished through use of a branch instead of a subsidiary.

Regardless of whether section 954(d)(2) is viewed as ambiguous or silent on the "manufacturing branch" issue, we conclude that the Secretary's manufacturing branch regulations are a "reasonable interpretation" of the statute. *Chevron*, 467 U.S. at 844. The Secretary was authorized to prescribe those regulations under section 954(d)(2), section 7805(a), or both. The statute does not "unambiguously foreclose[ ] the * * * interpretation" set forth in those regulations. *See Nat'l Cable & Telecomms. Ass'n v. Brand X Internet Servs.*, 545 U.S. 967, 982–983 (2005); *Vill. of Barrington v. Surface Transp. Bd.*, 636 F.3d 650, 659 (D.C. Cir. 2011) (quoting *Catawba Cty., N.C. v. EPA*, 571 F.3d 20, 35 (D.C. Cir. 2009)). And because the manufacturing branch regulations are fully consistent with Congress' intent as expressed in the legislative history, we cannot find those regulations to be "arbitrary, capricious, or manifestly contrary to the statute." *Chevron*, 467 U.S. at 844. We accordingly reject petitioners' challenge to the regulations' validity.[13]

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[13] "[N]either antiquity nor contemporaneity with * * * [a] statute is a condition of [a regulation's] validity." *Smiley v. Citibank (S.D.), N.A.*, 517 U.S. 735, 740 (1996). But it is relevant that the manufacturing branch rules have now been in existence for 55 years. *See Cottage Sav. Ass'n v. Commissioner*, 499 U.S. 554, 561 (1991) ("Treasury regulations and interpretations long continued without substantial change, applying to unamended or substantially reënacted statutes, are deemed to have received congressional approval and have the effect of law." (quoting *United States v. Correll*, 389 U.S. 299, 305–306 (1967))); *SIH Partners LLLP v. Commissioner*, 150 T.C. 28, 53 (2018) ("[I]t is relevant to * * * [the taxpayer's] case that the contested regulations had existed for nearly 50 years at the time * * * [of

To implement the foregoing,

Appropriate orders will be issued.

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the] transaction at issue."), *aff'd*, 923 F.3d 296 (3d Cir. 2019). Congress has repeatedly amended and reenacted section 954 without expressing any disagreement with the manufacturing branch rules. *See, e.g.*, Tax Reduction Act of 1975, Pub. L. No. 94–12, sec. 602(b), 89 Stat. at 58. There is no evidence that Congress has ever regarded these rules as unreasonable or contrary to its purpose in enacting subpart F.

Nos. 20-1899/1900
UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

FILED
Mar 02, 2022
DEBORAH S. HUNT,
Clerk

WHIRLPOOL FINANCIAL CORPORATION; CONSOLIDATED SUBSIDIARIES, Petitioners-Appellants,	)	
v.	)	ORDER
COMMISSIONER OF INTERNAL REVENUE, Respondent-Appellee.	)	

BEFORE: NORRIS, KETHLEDGE, and NALBANDIAN, Circuit Judges.

The court received a petition for rehearing en banc. The original panel has reviewed the petition for rehearing and concludes that the issues raised in the petition were fully considered upon the original submission and decision of the cases. The petition then was circulated to the full court.[*] No judge has requested a vote on the suggestion for rehearing en banc.

[*] Judges White and Readler recused themselves from participation in this ruling.

Therefore, the petition is denied. Judge Nalbandian would grant rehearing for the reasons stated in his dissent.

ENTERED BY ORDER OF THE COURT:

/s/ Deborah S. Hunt

Deborah S. Hunt, Clerk

26 U.S.C. § 954 (2009)

§ 954. Foreign base company income

* * *

(d) Foreign base company sales income

(1) In general

For purposes of subsection (a)(2), the term "foreign base company sales income" means 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 controlled foreign corporation is created or organized, and

(B) the property is sold for use, consumption, or disposition outside such foreign country, or, in the case of property purchased on behalf of a related person, is purchased for use, consumption, or disposition outside such foreign country.

For purposes of this subsection, personal property does not include agricultural commodities which are not grown in the United States in commercially marketable quantities.

(2) Certain branch income

For purposes of determining foreign base company sales income in situations in which the carrying on of activities by a controlled foreign corporation through a branch or similar establishment outside the country of incorporation of the controlled foreign corporation has substantially the same effect as if such branch or similar establishment were a wholly owned subsidiary corporation deriving such income, under regulations prescribed by the Secretary the income attributable to the carrying on of such activities of such branch or similar establishment shall be treated as income derived by a wholly owned subsidiary of the controlled foreign corporation and shall constitute foreign base company sales income of the controlled foreign corporation.

(3) Related person defined

For purposes of this section, a person is a related person with respect to a controlled foreign corporation, if—

(A) such person is an individual, corporation, partnership, trust, or estate which controls, or is controlled by, the controlled foreign corporation, or

(B) such person is a corporation, partnership, trust, or estate which is controlled by the same person or persons which control the controlled foreign corporation.

For purposes of the preceding sentence, control means, with respect to a corporation, the ownership, directly or indirectly, of stock possessing more than 50 percent of the total voting power of all classes of stock entitled to vote or of the

total value of stock of such corporation. In the case of a partnership, trust, or estate, control means the ownership, directly or indirectly, of more than 50 percent (by value) of the beneficial interests in such partnership, trust, or estate. For purposes of this paragraph, rules similar to the rules of section 958 shall apply.

(4) Special rule for certain timber products

For purposes of subsection (a)(2), the term "foreign base company sales income" includes any income (whether in the form of profits, commissions, fees, or otherwise) derived in connection with—

(A) the sale of any unprocessed timber referred to in section 865(b), or

(B) the milling of any such timber outside the United States.

Subpart G shall not apply to any amount treated as subpart F income by reason of this paragraph.

* * *

26 C.F.R. § 1.954-3 (2009)

§ 1.954–3 Foreign base company sales income.

(a) *Income included*—

* * *

(4) *Property manufactured or produced by the controlled foreign corporation*—(i) *In general*. Foreign base company sales income does not include income of a controlled foreign corporation derived in connection with the sale of personal property manufactured, produced, or constructed by such corporation in whole or in part from personal property which it has purchased. A foreign corporation will be considered, for purposes of this subparagraph, to have manufactured, produced, or constructed personal property which it sells if the property sold is in effect not the property which it purchased. In the case of the manufacture, production, or construction of personal property, the property sold will be considered, for purposes of this subparagraph, as not being the property which is purchased if the provisions of subdivision (ii) or (iii) of this subparagraph are satisfied. For rules of apportionment in determining foreign base company sales income derived from the sale of personal property purchased and used as a component part of property which is not manufactured, produced, or constructed, see subparagraph (5) of this paragraph.

(ii) *Substantial transformation of property*. If purchased personal property is substantially transformed prior to sale, the property sold will be treated as having been manufactured, produced, or constructed by the selling corporation.

* * *

(b) *Branches of controlled foreign corporation treated as separate corporations*—(1) *General rules for determining when to apply separate treatment*—(i) *Sales or purchase branch—(a) In general.* If a controlled foreign corporation carries on purchasing or selling 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 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 foreign base company sales income of such corporation. See section 954(d)(2).

(*b*) *Allocation of income and comparison of effective rates of tax.* The determination as to whether such use of the branch or similar establishment has the same tax effect as if it were a wholly owned subsidiary corporation of the controlled foreign corporation shall be made by allocating to such branch or similar establishment only that income derived by the branch or establishment which, when the special rules of subparagraph (2)(i) of this paragraph are applied, is described in paragraph (a) of this section (but determined without applying subparagraphs (2), (3), and (4) of such paragraph). The use of the branch or similar establishment for such activities will be considered to have substantially the same tax effect as if it were a wholly owned subsidiary corporation of the controlled foreign corporation if the income

allocated to the branch or similar establishment under the immediately preceding sentence is, by statute, treaty obligation, or otherwise, taxed in the year when earned at an effective rate of tax that is less than 90 percent of, and at least 5 percentage points less than, the effective rate of tax which would apply to such income under the laws of the country in which the controlled foreign corporation is created or organized, if, under the laws of such country, the entire income of the controlled foreign corporation were considered derived by the corporation from sources within such country from doing business through a permanent establishment therein, received in such country, and allocable to such permanent establishment, and the corporation were managed and controlled in such country.

* * *

(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

foreign base company sales income of such corporation. See section 954(d)(2).

(*b*) *Allocation of income and comparison of effective rates of tax.* The determination as to whether such use of the branch or similar establishment has substantially the same tax effect as if the branch or similar establishment were a wholly owned subsidiary corporation of the controlled foreign corporation shall be made by allocating to the remainder of such controlled foreign corporation only that income derived by the remainder of such corporation, which, when the special rules of subparagraph (2)(i) of this paragraph are applied, is described in paragraph (a) of this section (but determined without applying subparagraphs (2), (3), and (4) of such paragraph). The use of the branch or similar establishment for such activities will be considered to have substantially the same tax effect as if it were a wholly owned subsidiary corporation of the controlled foreign corporation if income allocated to the remainder of the controlled foreign corporation under the immediately preceding sentence is, by statute, treaty obligation, or otherwise, taxed in the year when earned at an effective rate of tax that is less than 90 percent of, and at least 5 percentage points less than, the effective rate of tax which would apply to such income under the laws of the country in which the branch or similar establishment is located, if, under the laws of such country, the entire income of the controlled foreign corporation were considered derived by such corporation from sources within such country from doing business through a permanent establishment therein, received in such country, and allocable to such permanent establishment, and the

corporation were created or organized under the laws of, and managed and controlled in, such country.

* * *

(2) *Special rules*—(i) *Determination of treatment as a wholly owned subsidiary corporation.* For purposes of determining under this paragraph whether the use of a branch or similar establishment which is treated as a separate corporation has substantially the same tax effect as if the branch or similar establishment were a wholly owned subsidiary corporation of a controlled foreign corporation—

(*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.

(*b*) *Activities treated as performed on behalf of remainder of corporation.* With respect to purchasing or selling activities performed by or through the branch or similar establishment, such purchasing or selling activities shall—

(*1*) With respect to personal property manufactured, produced, constructed, grown, or extracted by the controlled foreign corporation, or

(*2*) With respect to personal property (other than property described in (1) of this subdivision (b)) purchased or sold, or purchased and sold, by the controlled foreign corporation,

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

(c) Activities treated as performed on behalf of branch. With respect to manufacturing, producing,

constructing, growing, or extracting activities performed by or through the branch or similar establishment, purchasing or selling activities performed by or through the remainder of the controlled foreign corporation with respect to the personal property manufactured, produced, constructed, grown, or extracted by or through the branch or similar establishment shall be treated as performed on behalf of the branch or similar establishment.

(*d*) *Determination of hypothetical tax.* To the extent applicable, the principles of paragraph (b)(4)(ii) of § 1.954–1 shall be used in determining, under subdivision (i) of subparagraph (1) of this paragraph, the effective rate of tax which would apply to the income of the branch or similar establishment under the laws of the country in which the controlled foreign corporation is created or organized, or in determining, under subdivision (ii) of such subparagraph, the effective rate of tax which would apply to the income of the branch or similar establishment under the laws of the country in which the manufacturing, producing, constructing, growing, or extracting branch or similar establishment is located.

(*e*) *Tax laws to be taken into account.* Tax determinations shall be made by taking into account only the income, war profits, excess profits, or similar tax laws (or the absence of such laws) of the countries involved.

(ii) *Determination of foreign base company sales income.* Once it has been determined under subparagraph (1) of this paragraph that a branch or similar establishment and the remainder of the controlled foreign corporation are to be treated as

separate corporations, the determination of whether such branch or similar establishment, or the remainder of the controlled foreign corporation, as the case may be, has foreign base company sales income shall be made by applying the following rules:

(*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.

(*b*) *Activities treated as performed on behalf of remainder of corporation.* With respect to purchasing or selling activities performed by or through the branch or similar establishment, such purchasing or selling activities shall—

(*1*) With respect to personal property manufactured, produced, constructed, grown, or extracted by the controlled foreign corporation, or

(*2*) With respect to personal property (other than property described in (1) of this subdivision (b)) purchased or sold, or purchased and sold, by the controlled foreign corporation,

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

(*c*) *Activities treated as performed on behalf of branch.* With respect to manufacturing, producing, constructing, growing, or extracting activities performed by or through the branch or similar establishment, purchasing or selling activities performed by or through the remainder of the controlled foreign corporation with respect to the personal property manufactured, produced, constructed, grown, or extracted by or through the

branch or similar establishment shall be treated as performed on behalf of the branch or similar establishment.

(*d*) *Items not to be twice included in income.* Income which is classified as foreign base company sales income as a result of the application of subdivision (i) of subparagraph (1) of this paragraph shall not be again classified as foreign base company sales income as a result of the application of subdivision (ii) of such subparagraph.

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

(*f*) *Priority of application.* If income derived by the branch or similar establishment, or by the remainder of the controlled foreign corporation, from a transaction would be classified as foreign base company sales income of such controlled foreign corporation under section 954(d)(1) and paragraph (a) of this section, the income shall, notwithstanding this paragraph, be treated as foreign base company sales income under paragraph (a) of this section and the branch or similar establishment shall not be treated as a separate corporation with respect to such income.

(3) *Inclusion of amounts in gross income of United States shareholders.* A branch or similar establishment of a controlled foreign corporation and the remainder of such corporation shall be treated as separate corporations under this paragraph solely for purposes of determining the foreign base company

sales income of each such corporation and for purposes of including an amount in subpart F income of the controlled foreign corporation under section 953(a). See section 954(b)(3) and paragraph (d)(4) of § 1.954–1 for rules relating to the treatment of a branch or similar establishment of a controlled foreign corporation and the remainder of such corporation as separate corporations for purposes of independently determining if the foreign base company income of each such corporation is less than 10 percent, or more than 70 percent, of its gross income. For all other purposes, however, a branch or similar establishment of a controlled foreign corporation and the remainder of such corporation shall not be treated as separate corporations. For example, if the controlled foreign corporation has a deficit in earnings and profits to which section 952(c) applies, the limitation of such section on the amount includable in the subpart F income of such corporation will apply. Moreover, income, war profits, or excess profits taxes paid by a branch or similar establishment to a foreign country will be treated as having been paid by the controlled foreign corporation for purposes of section 960 (relating to special rules for foreign tax credit) and the regulations thereunder. Also, income of a branch or similar establishment, treated as a separate corporation under this paragraph, will not be treated as dividend income of the controlled foreign corporation of which it is a branch or similar establishment.

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

Example 1. Controlled foreign corporation A, incorporated under the laws of foreign country X, is engaged in the manufacturing business in such

country. Corporation A negotiates sales of its products for use outside of country X through a sales office, branch B, maintained in foreign country Y. These activities constitute the only activities of A Corporation. Country X levies an income tax at an effective rate of 50 percent on the income of A Corporation derived by the manufacturing plant in country X but does not tax the sales income of A Corporation derived by branch B in country Y. Country Y levies an income tax at an effective rate of 10 percent on the sales income derived by branch B but does not tax the income of A Corporation derived by the manufacturing plant in country X. If the sales income derived by branch B were, under the laws of country X, derived from sources within country X by A Corporation, such income would be taxed by such country at an effective rate of 50 percent. In determining foreign base company sales income of A Corporation, branch B is treated as a separate wholly owned subsidiary corporation of A Corporation, the 10 percent rate of tax on branch B's income being less than 90 percent of, and at least 5 percentage points less than, the 50 percent rate. Income derived by branch B, treated as a separate corporation, from the sale by or through it for use, consumption, or disposition outside country Y of the personal property produced in country X is treated as income from the sale of personal property on behalf of A Corporation, a related person, and constitutes foreign base company sales income. The remainder of A Corporation, treated as a separate corporation, derives no foreign base company sales income since it produces the product which is sold.

Example 2. Controlled foreign corporation C is incorporated under the laws of foreign country X.

Corporation C maintains branch B in foreign country Y. Branch B manufactures articles in country Y which are sold through the sales offices of C Corporation located in country X. These activities constitute the only activities of C Corporation. Country Y levies an income tax at an effective rate of 30 percent on the manufacturing profit of C Corporation derived by branch B but does not tax the sales income of C Corporation derived by the sales offices in country X. Country X does not impose an income, war profits, excess profits, or similar tax, and no tax is paid to any foreign country with respect to income of C Corporation which is not derived by branch B. If C Corporation were incorporated under the laws of country Y, the sales income of the sales offices in country X would be taxed by country Y at an effective rate of 30 percent. In determining foreign base company sales income of C Corporation, branch B is treated as a separate wholly owned subsidiary corporation of C Corporation, the zero rate of tax on the income derived by the remainder of C Corporation being less than 90 percent of, and at least 5 percentage points less than, the 30 percent rate. Branch B, treated as a separate corporation, derives no foreign base company sales income since it produces the product which is sold. Income derived by the remainder of C Corporation, treated as a separate corporation, from the sale by or through it for use, consumption, or disposition outside country X of the personal property produced in country Y is treated as income from the sale of personal property on behalf of branch B, a related person, and constitutes foreign base company sales income.

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