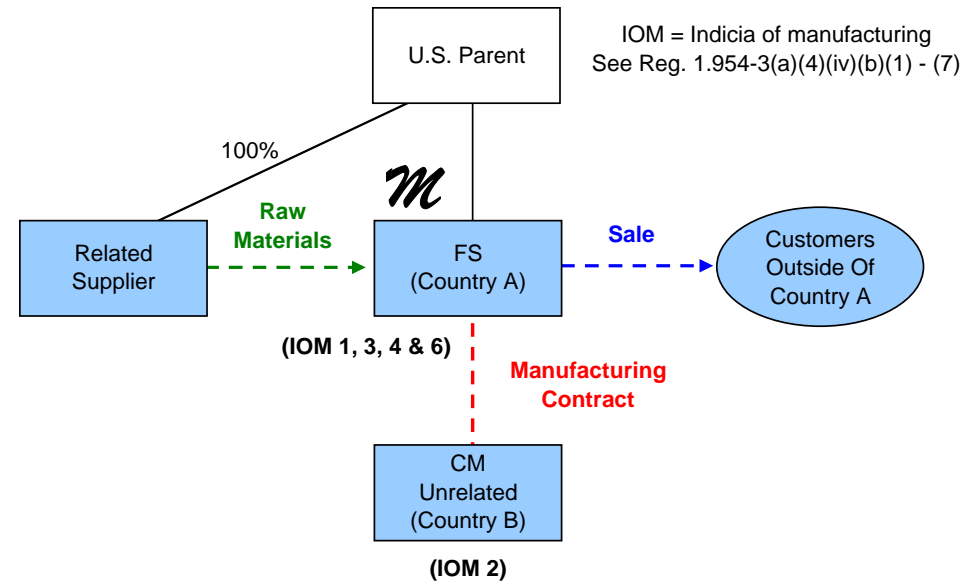


**SC With Direction and Oversight of Mfg. and Quality Control Through Periodic Visits (IOM 1, 3, 4 & 6)**

**FS activities thru its own employees ("Indicia of Manufacturing")**

- |  |     |
|--|-----|
| 1. Oversee and direct manufacturing activities or process.   | Yes |
| 2. Physically transform product.   | No  |
| 3. Select materials, select vendors, or control raw materials, work-in-process, or finished goods.                                       | Yes |
| 4. Manage manufacturing costs or capacities (risk of loss, demand planning, production scheduling, hedging, etc.).                       | Yes |
| 5. Control manufacturing related logistics.  | No  |
| 6. Control quality.  | Yes |
| 7. Develop, or direct the use or development of, product design and other intellectual property related to manufacturing of the product. | No  |



FS, a controlled foreign corporation, purchases raw materials from a related person. The raw materials are manufactured into Product X by CM, an unrelated corporation, pursuant to a contract manufacturing arrangement. CM physically performs the substantial transformation, assembly, or conversion outside of FS's country of organization. Product X is sold by FS for use outside of FS's country of organization. FS controls the raw material, work-in-process, and finished goods, manages the manufacturing costs and capacities, and provides oversight and direction of the manufacture of Product X. Employees of FS visit CM's manufacturing facility for one week each quarter and perform quality control tests on a random sample of the units of Product X produced during the week. In the X industry, quarterly visits to a manufacturing facility by qualified persons are sufficient to control the quality of manufacturing. If the manufacturing activities undertaken with respect to Product X prior to sale had been undertaken by FS through the activities of its employees, FS would have satisfied the manufacturing exception contained in Reg. 1.954-3(a)(4)(ii) or (a)(4)(iii) with respect to Product X. Therefore, Reg. 1.954-3(a)(4)(iv) applies. Under the facts and circumstances of the business, FS satisfies the test under Reg. 1.954-3(a)(4)(iv) with respect to Product X because it makes a substantial contribution through the activities of its employees to the manufacture of Product X. Therefore, FS is considered to have manufactured Product X under Reg. 1.954-3(a)(4)(i).