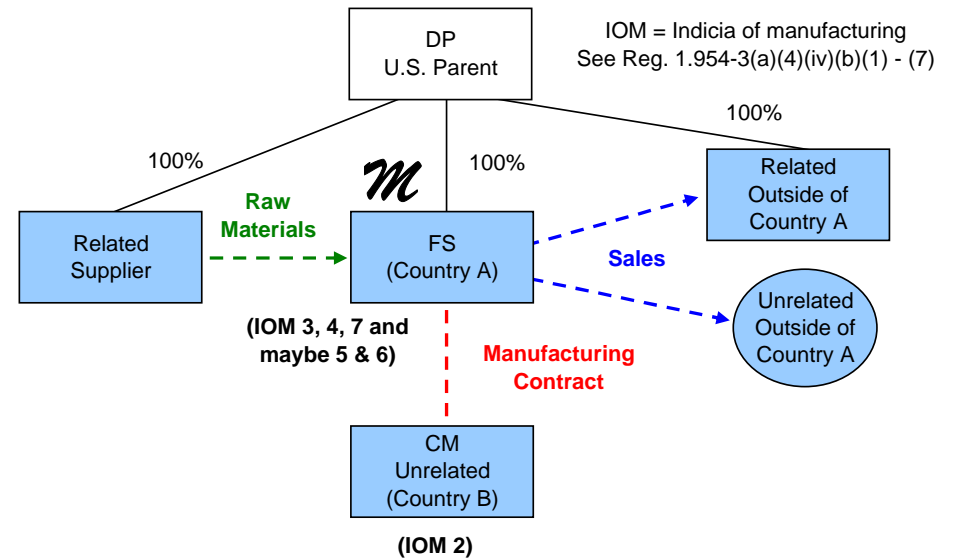


FS activities thru its own employees ("Indicia of Manufacturing")

1. Oversee and direct manufacturing activities or process.	No
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.	Auto'd
6. Control quality.	Auto'd
7. Develop, or direct the use or development of, product design and other intellectual property related to manufacturing of the product.	Yes



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 selected by FS, 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 to related and unrelated persons for use outside of FS's country of organization. At all times, FS retains ownership of the raw materials, work-in-process, and finished goods. FS retains the right to oversee and direct the activities or process pursuant to which Product X is manufactured by CM, but does not exercise, through its employees, its powers of oversight and direction. FS is the owner of sophisticated software and network systems that remotely and automatically (without human involvement) take orders, route them to CM, order raw materials, and perform quality control. FS has a small number of computer technicians who monitor the software and network systems to ensure that they are running smoothly and apply any necessary patches or fixes. The software and network systems were purchased by FS. FS's employees supervise the computer technicians, evaluate the results of the automated manufacturing business, and make ongoing operational decisions, including decisions related to acceptable performance of the manufacturing process, stoppages of that process, and decisions related to product and manufacturing process design. The upgrades to the software and network systems are purchased by FS. FS employees also direct and control other aspects of the manufacturing process such as vendor and material selection, management of the manufacturing costs and capacities, and the selection of CM. DP's employees contribute to product and manufacturing process design, and provide support and oversight to FS in connection with functions performed by FS through its employees. 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) because it makes a substantial contribution through the activities of its employees to the manufacture of Product X. This determination does not require a comparison between the activities of FS and the activities of DP. Selection of the contract manufacturer, even though not specifically identified in Reg. 1.954-3(a)(4)(iv)(b), is considered under Reg. 1.954-3(a)(4)(iv)(c) in determining whether FS makes a substantial contribution to the manufacture of Product X through its employees. FS is considered to have manufactured Product X under Reg. 1.954-3(a)(4)(i).