

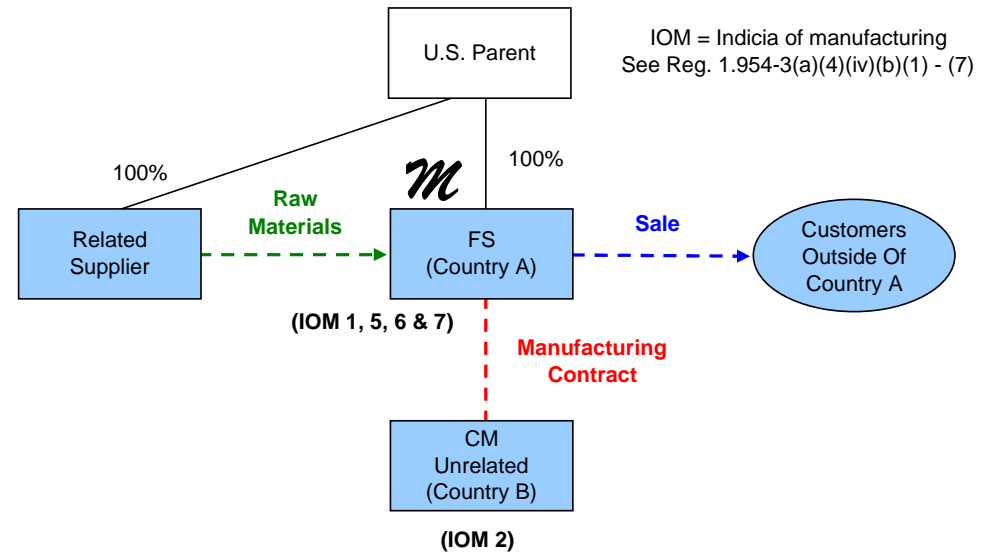
Reg. 1.954-3(a)(4)(iv)(d), Ex. 2

**Substantial Contribution ("SC")
(IOM 1, 5, 6, & 7)**

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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.	No
4. Manage manufacturing costs or capacities (risk of loss, demand planning, production scheduling, hedging, etc.).	Unstated
5. Control manufacturing related logistics.	Yes
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.	Yes



FS, a controlled foreign corporation, purchases raw materials from a related person. The raw materials are manufactured (under the principles of Reg. 1.954-3(a)(4)(ii) or (a)(4)(iii)) 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. Under the terms of the contract, FS retains the right to control the raw materials, work-in-process, and finished goods, and the right to oversee and direct the activities or process pursuant to which Product X is manufactured by CM. FS owns the intellectual property used in the manufacturing process. FS, through its employees, engages in product design and quality control and controls manufacturing related logistics. Further, employees of FS exercise the right to oversee and direct the activities of CM in the manufacture of Product X. However, FS does not exercise, through its employees, its powers to control the raw materials, work-in-process, or finished goods.

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. Therefore, FS is considered to have manufactured Product X under Reg. 1.954-3(a)(4)(i). The analysis and conclusion would be the same if CM were related to FS because the relationship between CM and FS is irrelevant for purposes of applying Reg. 1.954-3(a)(4)(i).