

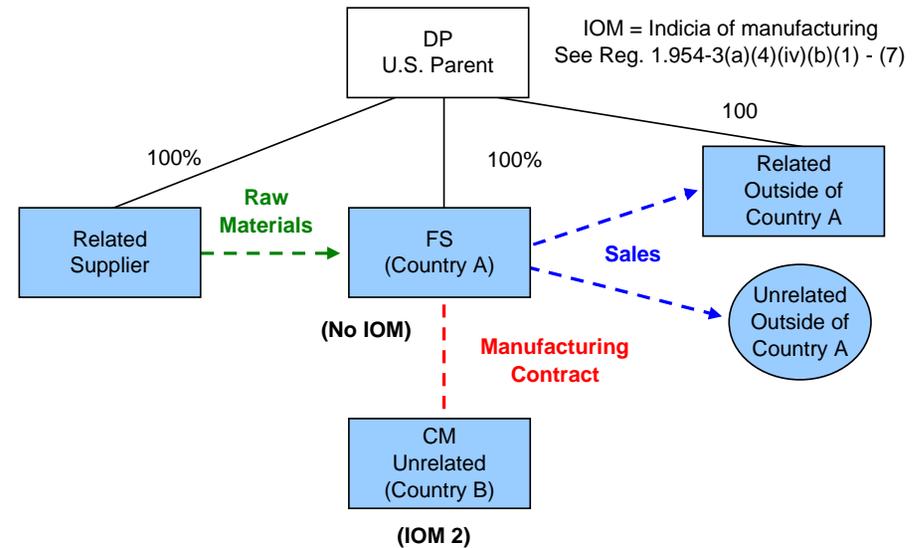
**Reg. 1.954-3(a)(4)(iv)(d), Ex. 5**

**No SC With Auto'd Mfg. Supervised  
By Another (No IOM)**

Copyright © 2009 Andrew Mitchel LLC  
International Tax Services  
www.andrewmitchel.com

**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.                                       | No     |
| 4. Manage manufacturing costs or capacities (risk of loss, demand planning, production scheduling, hedging, etc.).                       | No     |
| 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. | 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 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 developed by employees of DP, the U.S. corporate parent of FS. DP'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. DP's employees develop and provide to FS all of the upgrades to the software and network systems. DP also has employees who 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. The need for DP's employees to direct the activities of the FS employees and otherwise contribute to the manufacturing process evinces that substantial operational responsibilities and decision making are required to be exercised by parties other than CM in order to manufacture Product X. 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 circumstance of the business, FS does not satisfy the test under Reg. 1.954-3(a)(4)(iv) because it does not make a substantial contribution through the activities of its employees to the manufacture of Product X. Mere ownership of materials and intellectual property along with contractual rights to exercise powers of direction and control are not sufficient to satisfy Reg. 1.954-3(a)(4)(iv). The employees of FS do not perform the amount of activity necessary to constitute a substantial contribution. FS is not considered to have manufactured Product X under Reg. 1.954-3(a)(4)(i).