



OFFICE OF
CHIEF COUNSEL

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

2003-04 12/08/03

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ACTION ON DECISION

Subject: General Electric Co. & Subs. v. Commissioner,
T.C. Memo. 1995-306, rev'd in part, vacated in part, and
remanded, 245 F.3d 149 (2d Cir. 2001)
T.C. Dkt. No. 14715-92

Issue:

Whether aircraft engines and thrust reversers sold by the taxpayer through its wholly-owned domestic international sales corporation (ADISC®) to airframe manufacturers for incorporation in the United States into aircraft that are delivered for use outside the United States constitute export property within the meaning of section 993(c)(1)(B) of the Internal Revenue Code and Treas. Reg. ' 1.993-3(d)(2)(iii).

Discussion:

Based on fully stipulated facts, the Tax Court held in General Electric, T.C. Memo. 1995-306, that General Electric (AGE®) aircraft engines and thrust reversers were not export property under section 993(c)(1)(B). The Tax Court reasoned that the engines and thrust reversers were subject to assembly within the meaning of Treas. Reg. ' 1.993-3(d)(2)(iii) when they were attached to (and, thus, incorporated into) airframes after sale but prior to delivery for use outside the United States. See H. Rep. 92-533 (1971), reprinted in 1972-1 C.B. 498, 532 (articulating the concept of incorporation). Because the engines and thrust reversers were not export property, the DISC provisions under sections 991 through 997 did not apply to the sales of these products.

The Second Circuit Court of Appeals reversed the decision of the Tax Court with respect to the engines and vacated the Tax Court's judgment with respect to the thrust reversers. The Second Circuit held that the attachment of engines to an airframe does not constitute assembly or other processing under Treas. Reg. ' 1.993-3(d)(2)(iii). The court reasoned that, because engines and airframes are separate and distinct from one another legally (for example, as treated by the Federal Aviation Administration), physically,

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contractually, and as viewed by the aviation industry, the attachment of an engine to an airframe constitutes mere affixing of one export product to another. Therefore, GE had complied with Treas. Reg. ' 1.993-3(d)(2)(iii), the engines constituted export property, and the DISC provisions applied to the engine sales. The Second Circuit also observed that tax treatment of the engines and thrust reversers may differ materially. Because the Tax Court's analysis did not differentiate between the engines and the thrust reversers, the Second Circuit remanded the thrust reverser issue to the Tax Court for further consideration in light of its opinion.

In 1985, the DISC provisions were substantially replaced by the foreign sales corporation (AFSC) provisions under sections 921 through 927 which were repealed effective October 1, 2000 (subject to limited transition relief). When Congress repealed the FSC provisions, it replaced them with the extraterritorial income exclusion provisions under sections 114 and 941 through 943. Both the FSC and the extraterritorial income exclusion provisions incorporated concepts analogous to those litigated in General Electric. Noting that under current industry practice the purchaser of an aircraft contracts separately for the engine and the airframe, the legislative history for the extraterritorial income exclusion provisions states that the extraterritorial income exclusion applies to sales of aircraft engines in circumstances similar to the General Electric fact pattern. Technical Explanation of the Senate Amendment to H.R. 4986, the AFSC Repeal and Extraterritorial Income Exclusion Act of 2000 (JCX-111-00), p.9 (November 1, 2000).

Considering the above, the Service will not challenge the position that aircraft engines may constitute export property under section 993(c)(1)(B) (as well as sections 927(a)(1)(B) and 943(a)(1)(B)) in circumstances similar to the General Electric fact pattern. With respect to aircraft engines and other products in circumstances different from the General Electric fact pattern, the Service will maintain that Treas. Reg. ' 1.993-3(d)(2)(iii) (and Temp. Treas. Reg. ' 1.927(a)-1T(d)(2)(iii)) deny export property status to a product that is incorporated into another product after sale but prior to delivery for use outside the United States.

Recommendation: Acquiescence in result only.

Approved:

EMILY A. PARKER
Acting Chief Counsel

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