

LB&I Concept Unit Knowledge Base – International

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Book	2	Deferral Planning
Chapter	1	Foreign base company sales issues
Section	2.1.1	Substantial Contribution
Subsection		

Unit Name	Substantial Contribution Test for CFC Manufacturing Exception	
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General Overview

Substantial Contribution Test for CFC Manufacturing Exception

A U.S. shareholder of a foreign corporation generally is not subject to tax on the income of the corporation until the shareholder receives a distribution from the corporation. However, under subpart F, certain types of income earned by a controlled foreign corporation (CFC) are included in the current income of the CFC's U.S. shareholders even if the CFC does not distribute the income to its shareholders in that year.

One such type of income is Foreign Base Company Sales Income (FBCSI), which is income derived by a CFC in connection with a purchase or sale* of personal property involving a related party in which the goods are manufactured and sold for use/consumption outside the CFC's country of organization. The provisions of subpart F generally require a U.S. shareholder to include its pro-rata share of the CFC's FBCSI in its current income. However, when Congress enacted the FBCSI rules, it was focused on "income from the purchase and sale of property, without any appreciable value being added to the product by the selling corporation" (S. Rep. No. 1881, 87th Cong., 2d Sess., reprinted at 1962-3 CB 703, 790). As such, Treas. Reg. 1.954-3(a)(4) provides that FBCSI does not include income in connection with the purchase or sale of property manufactured, produced, or constructed by the CFC itself ("CFC manufacturing exception").

A CFC is generally eligible for the CFC manufacturing exception if it satisfies one of the following three tests:

- Substantial Transformation Test---Treas. Reg. 1.954-3(a)(4)(ii)
- Component Parts Test---Treas. Reg. 1.954-3(a)(4)(iii)
- Substantial Contribution Test---Treas. Reg. 1.954-3(a)(4)(iv)

The first two tests are often referred to collectively as the physical manufacturing tests and are not covered in this IPS unit. The third test, which is the focus of this unit, may apply when a CFC is involved in the manufacturing process but does not satisfy the physical manufacturing tests.

*Note that FBCSI includes income from selling or purchasing, but often only sales/selling is mentioned for ease of reference.

General Overview (cont'd)

Substantial Contribution Test for CFC Manufacturing Exception

The substantial contribution test for manufacturing provides that a CFC will be considered to have manufactured the personal property it sells if the facts and circumstances evince that the CFC makes a substantial contribution through its employees to the manufacture, production, or construction (hereafter simply “manufacture”) of such property. Treas. Reg. 1.954-3(a)(4)(iv)(b) provides a non-exclusive list of activities (“indicia of manufacturing” which are covered in detail later in this unit) to be considered in determining whether the CFC makes a substantial contribution to manufacturing. All the activities of the CFC’s employees that contribute directly to the manufacture of the property are considered in the aggregate in order to determine whether the activities constitute a substantial contribution to manufacturing. All functions performed by the CFC’s employees that contribute to the manufacture of the relevant product will be taken into account, whether or not they are listed in the indicia of manufacturing. However, any CFC employees’ activities not listed in the indicia should be considered only to the extent they directly contribute to the manufacture of the property.

Substantial contribution is a test for the CFC manufacturing exception, and as such, does not take into account any activities that merely contribute to the business in general (e.g. sales, marketing, finance, etc.). In fact, a CFC through its employees may perform indispensable functions for the business and still not satisfy the substantial contribution test for the CFC manufacturing exception. The test only considers those activities that contribute directly to the manufacture of the property, and therefore any other activities should not be considered, no matter how substantial their contribution is to the rest of the business.

In order to determine whether a CFC makes a substantial contribution to manufacturing, the examiner must perform a functional analysis to identify what activities are performed in manufacturing the property and who performs these activities. The functional analysis will give the examiner a clear picture of the entire manufacturing process and the relative significance of the activities performed by the CFC’s employees with respect to that process. Note, however, that the functional analysis for the substantial contribution test for manufacturing should focus on whether the activities of the CFC itself are substantial without comparing those activities to the activities of other persons. By understanding the importance of the contribution of the CFC’s employees’ activities relative to the entire manufacturing process (not relative to other persons), the examiner can properly determine whether the CFC makes a substantial contribution to the manufacture of a particular product, when considering the key elements of the manufacturing process for that particular product.

Relevant Key Factors

Substantial Contribution Test for CFC Manufacturing Exception

Key Factors

Performing a functional analysis can be a time-consuming process, and therefore the examiner should begin the process as early in the examination as possible. Examiners may refer to IP Unit “Conducting Functional Analysis for Foreign Base Company Income” (DPL/P/02_06-01; formerly DPL/PUO/P_2.6_12 (2015)) for additional guidance.



CONSULTATION: The examiner should consult an Engineer for assistance with the functional analysis.

The functional analysis enables the examiner to determine whether a CFC makes a substantial contribution through the activities of its employees to the manufacture of the personal property the CFC sells. Treas. Reg. 1.954-3(a)(4)(iv)(b) provides that this determination involves, but is not necessarily limited to, consideration of the following activities.

1. Oversight and direction of the activities or process pursuant to which the property is physically manufactured.
2. Performance of some physical manufacturing activities that are considered in, but are insufficient to satisfy, the substantial transformation and component parts tests for the CFC manufacturing exception.
3. Material selection, vendor selection, or control of raw materials, work-in-process, or finished goods.
4. Management of manufacturing costs or capacities (for example, managing risk of loss, cost reduction, or efficiency initiatives associated with the manufacturing process, demand planning, etc.).
5. Control of manufacturing related logistics.
6. Quality control (for example, sample testing or establishment of quality control standards).
7. Developing (or directing the use or development of) trade secrets, technology, product design and design specifications, or other intellectual property (IP) for the purpose of manufacturing the product (excludes marketing IP such as trademarks).

Detailed Explanation of the Concept

Substantial Contribution Test for CFC Manufacturing Exception

Consideration of activities, or indicia of manufacturing

Analysis	Resources
<p>When determining whether the CFC through its employees makes a substantial contribution to the manufacture of the relevant personal property:</p> <ul style="list-style-type: none"> • The performance of any activity listed in the indicia of manufacturing at Treas. Reg. 1.954-3(a)(4)(iv)(b) will be taken into account; • The performance or lack of performance of any particular manufacturing activity is not determinative; • The weight accorded to the performance of any quantum of manufacturing activity will vary with the facts and circumstances of the particular business based on the economic significance of those functions to the manufacturing process; • There is no minimum performance threshold before a manufacturing activity can be considered. (Remember that all the activities of the CFC's employees that contribute directly to the manufacture of the property are considered in the aggregate in order to determine whether the activities constitute a substantial contribution to manufacturing). Note that this does NOT mean there is a low threshold for qualifying under the substantial contribution test for the CFC manufacturing exception – it simply means that all activities (not only “major” activities) are considered in the aggregate; and • The fact that other persons make a substantial contribution to the same manufacturing process does not preclude the CFC itself from making a substantial contribution to that manufacturing process. 	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.954-3(a)(4)(iv)(c) ▪ T.D. 9438

Detailed Explanation of the Concept (cont'd)

Substantial Contribution Test for CFC Manufacturing Exception	
Analysis	Resources
<p>In addition, when considering the indicia of manufacturing, note the following factors:</p> <ul style="list-style-type: none">• Mere contractual rights, legal title, tax ownership, or assumption of economic risk are not considered in the substantial contribution analysis.• Some of the activities in the indicia of manufacturing may overlap with other activities. It is not necessary to determine whether an activity falls within one or more indicia.• The Regulations require a substantial contribution to the manufacture of the personal property through the activities of the CFC's employees and not the satisfaction of any specific activity in the indicia of manufacturing. <p>In summary, all the activities of the CFC's employees that contribute directly to the manufacture of the property are considered (and given appropriate weight) in the aggregate in order to determine whether the activities collectively constitute a substantial contribution to manufacturing.</p>	<ul style="list-style-type: none">▪ T.D. 9438

Detailed Explanation of the Concept (cont'd)

Substantial Contribution Test for CFC Manufacturing Exception	
Analysis	Resources
<p>1. Oversight and direction of the activities or process pursuant to which the property is physically manufactured</p> <p>The importance of this activity will vary based on the facts and circumstances associated with the manufacturing process at issue. This activity is likely to be an important element in many, but not all, substantial contribution analyses; it is not a prerequisite to satisfying the substantial contribution test for the CFC manufacturing exception.</p> <p>Oversight and direction of any other activity or process that is not related to the manufacture of the personal property is not taken into account in satisfying the substantial contribution test for the CFC manufacturing exception. For example, functions such as corporate oversight and direction of sales or marketing are not taken into account. Furthermore, the mere contractual right to oversee and direct the manufacturing process is not considered in the substantial contribution test for the CFC manufacturing exception.</p>	<ul style="list-style-type: none">▪ Treas. Reg. 1.954-3(a)(4)(iv)(b)▪ T.D. 9438

Detailed Explanation of the Concept (cont'd)

Substantial Contribution Test for CFC Manufacturing Exception	
Analysis	Resources
<p>2. Performance of some physical manufacturing activities that are considered in, but are insufficient to satisfy, the substantial transformation and component parts tests for the CFC manufacturing exception.</p> <p>3. Material selection, vendor selection, or control of raw materials, work-in-process, or finished goods</p> <p>The CFC does not need to own the raw materials used in the manufacturing process in order to satisfy the substantial contribution test for the CFC manufacturing exception (i.e., even if the goods a CFC sells are produced under a turnkey or buy-sell contract manufacturing (CM) arrangement, the CFC may still satisfy the substantial contribution test). However, mere contractual rights, legal title, tax ownership, or assumption of economic risk are not considered in the substantial contribution analysis. Only activities of the CFC's employees are considered in the substantial contribution analysis.</p>	<ul style="list-style-type: none">▪ Treas. Reg. 1.954-3(a)(4)(iv)(b)▪ T.D. 9438

Detailed Explanation of the Concept (cont'd)

Substantial Contribution Test for CFC Manufacturing Exception	
Analysis	Resources
<p>4. Management of manufacturing costs or capacities (for example, managing risk of loss, cost reduction or efficiency initiatives associated with the manufacturing process, demand planning, production scheduling, or hedging raw material costs.)</p> <p>The substantial contribution test recognizes contributions made by a CFC's employees to the manufacturing process through functions which help to ensure that a plant is run in an economically efficient manner, such as optimization of plant capacity and reduction of waste (for example, waste of raw materials). On the other hand, not all corporate managerial decisions are intended to be considered in the substantial contribution test for the CFC manufacturing exception, because many such decisions are not directly related to the manufacture of the personal property with respect to which the substantial contribution analysis is being performed. For example, corporate finance decisions are not considered in the substantial contribution test for the CFC manufacturing exception. Similarly, general management of enterprise risk is not considered in the substantial contribution test for the CFC manufacturing exception.</p>	<ul style="list-style-type: none">▪ Treas. Reg. 1.954-3(a)(4)(iv)(b)▪ T.D. 9438

Detailed Explanation of the Concept (cont'd)

Substantial Contribution Test for CFC Manufacturing Exception	
Analysis	Resources
<p>5. Control of manufacturing related logistics</p> <p>Control of manufacturing related logistics includes, for example, arranging for delivery of raw materials to a CM, but excludes, for example, delivery of finished goods to a customer.</p>	<ul style="list-style-type: none">▪ Treas. Reg. 1.954-3(a)(4)(iv)(b)▪ T.D. 9438
<p>6. Quality control (for example, sample testing or establishment of quality control standards)</p> <p>Recall that the weight accorded to the performance of any quantum of activity will vary with the facts and circumstances of the particular business based on the economic significance of those functions to the manufacturing process. As such, the importance of quality control activities will vary from case to case. For example, the quality control function for a manufacturer of high-precision, specialized goods is likely much more important than that of a manufacturer of commoditized goods. Likewise, if a CM has high standards for quality control (notwithstanding its relationship with the CFC), any quality control related activities of the CFC's employees should not be accorded much (if any) weight, because the CM is providing most (if not all) of the quality control function.</p>	

Detailed Explanation of the Concept (cont'd)

Substantial Contribution Test for CFC Manufacturing Exception	
Analysis	Resources
<p>7. Developing (or directing the use or development of) trade secrets, technology, product design and design specifications, or other IP for the purpose of manufacturing the product (excludes marketing IP such as trademarks)</p> <p>Activities of this nature are considered under the substantial contribution test for the CFC manufacturing exception only when undertaken for the purpose of the manufacture of the personal property. Thus, developing, or directing the use or development of, marketing intangibles is not considered in the substantial contribution test. For example, activities related to developing the process for manufacturing Product X would be considered, whereas activities related to the brand name or trademark for Product X would not be taken into account.</p>	<ul style="list-style-type: none">▪ Treas. Reg. 1.954-3(a)(4)(iv)(b)▪ T.D. 9438

Detailed Explanation of the Concept (cont'd)

Substantial Contribution Test for CFC Manufacturing Exception	
Analysis	Resources
<p>Remember, the substantial contribution determination is not necessarily limited to consideration of the seven activities discussed in the preceding slides. Other activities of the CFC's employees should be considered, but only to the extent the activities contribute directly to the manufacture of the personal property. As such, any non-manufacturing related activities, no matter how significant to the business, are not taken into account in determining whether the CFC makes a substantial contribution to manufacturing.</p> <p>The substantial contribution test does not require satisfaction of any specific activity in the indicia of manufacturing. As such, it is both unnecessary and inappropriate to treat the seven indicia as a checklist. A CFC does not satisfy, or fail to satisfy, any specific activity in the indicia; rather the CFC satisfies, or fails to satisfy, the substantial contribution test for manufacturing. Likewise, it is not necessary to clarify whether any particular activity might reasonably be included under more than one heading in the indicia of manufacturing. Instead, all the activities of the CFC's employees that directly contribute to the manufacture of the relevant personal property must be considered collectively in order to determine whether the CFC makes a substantial contribution to manufacturing.</p>	<ul style="list-style-type: none">▪ Treas. Reg. 1.954-3(a)(4)(iv)(b)▪ T.D. 9438

Detailed Explanation of the Concept (cont'd)

Substantial Contribution Test for CFC Manufacturing Exception

Analysis

Only activities performed by the CFC's employees are taken into account in determining whether the CFC makes a substantial contribution (i.e., activities of individuals who are not employees of the CFC are not taken into account). The term "employee" means an individual who, under Treas. Reg. 31.3121(d)-1(c), has the status of an employee for U.S. Federal tax purposes. This definition may encompass certain seconded workers, part-time workers, workers on the payroll of a related employment company whose activities are directed and controlled by CFC employees, and contractors, but only if those individuals are employees of the CFC under Treas. Reg. 31.3121(d)-1(c).

An individual may be treated as an employee of two or more entities simultaneously. Activities of individuals who are employees of the CFC and one or more other entities simultaneously may be taken into account in determining whether the CFC makes a substantial contribution to manufacturing, provided the activities are performed in the individuals' capacities as employees of the CFC. However, in the case of individuals who are employees of both the US parent (USP) and the CFC, examiners should ascertain whether activities of the individuals are duplicative of their responsibilities as employees of USP.

Resources

- Treas. Reg. 1.954-3(a)(4)(iv)(b)
- Treas. Reg. 1.954-3(a)(4)(i)
- T.D. 9438

Examples of the Concept

Substantial Contribution Test for CFC Manufacturing Exception

Examples

Recall that the examiner must develop the facts by performing a functional analysis to identify the activities undertaken to manufacture the property and the parties who perform those activities. The examiner performs this functional analysis in order to determine whether a CFC satisfies the substantial contribution test for the CFC manufacturing exception. In the following examples (which are largely based on the examples in Treas. Reg. 1.954-3(a)(4)(iv)), assume a functional analysis was performed, resulting in the facts that are given.

- Example 1 – Facts: CFC has the right to control raw materials, work in process, and finished goods; and the right to oversee and direct the manufacture of Product X by CM; and CFC owns the IP used in the manufacturing process. CFC does not exercise its power to control the raw materials, work in process, or finished goods; and CFC does not exercise its powers of oversight and direction. CFC also does not develop or direct the use or development of the IP for the purpose of manufacturing Product X.

Result: CFC does not satisfy the substantial contribution test for the CFC manufacturing exception.

Note: Mere contractual rights to control materials, contractual rights to oversee and direct the manufacturing, and ownership of IP are not considered in the substantial contribution test.

Examples of the Concept (cont'd)

Substantial Contribution Test for CFC Manufacturing Exception

Examples

- Example 2 – Facts: Same as Example 1, except for the following. CFC, through its employees, engages in product design and quality control and controls manufacturing related logistics. CFC's employees oversee and direct the activities of CM in the manufacture of Product X.

Result: CFC satisfies the substantial contribution test for the CFC manufacturing exception.

Note: The fact that CFC exercised its right to oversee and direct the manufacturing is not the sole reason that the results are different in the two examples given above. In Example 2, CFC also engaged in product design and quality control and controlled manufacturing related logistics. These activities were considered in the aggregate to determine that CFC satisfied the substantial contribution test for the CFC manufacturing exception in Example 2.

Examples of the Concept (cont'd)

Substantial Contribution Test for CFC Manufacturing Exception

Examples

- Example 3 – Facts: CFC, through its employees, selects (but does not own) the materials used to manufacture Product X. CFC's employees exercise oversight and direction of the manufacturing process and provides quality control. CFC, through its employees, manages the manufacturing costs and capacities with respect to Product X by managing risk of loss and engaging in demand planning and production scheduling.

Result: CFC satisfies the substantial contribution test for the CFC manufacturing exception.

Note: In Example 3, it was not necessary for CFC to hold title to the materials used to manufacture Product X. Remember, mere legal ownership is neither sufficient nor required to satisfy the substantial contribution test for the CFC manufacturing exception.

Note the contrast between Examples 1 and 3. In Example 1, CFC's employees did not actually perform any of the activities described in the indicia (but merely had some contractual rights and legal ownership) and thus did not satisfy the substantial contribution test. In Example 3, CFC's employees performed a wide variety of significant activities to contribute directly to the manufacture of Product X, and thus CFC satisfied the substantial contribution test for the CFC manufacturing exception. In practice, determining whether the CFC makes a substantial contribution to manufacturing is often much more ambiguous.

Examples of the Concept (cont'd)

Substantial Contribution Test for CFC Manufacturing Exception

Examples

- Example 4 – Facts: CM performs physical manufacturing of product X through contractors. Apart from the physical manufacturing, CFC, through its employees, performs all of the other manufacturing activities required to manufacture Product X (for example, oversight and direction of the manufacturing process; vendor selection; control of raw materials, work in process, and finished goods; control of manufacturing related logistics; and quality control).

Result: CFC satisfies the substantial contribution test for the CFC manufacturing exception.

Examples of the Concept (cont'd)

Substantial Contribution Test for CFC Manufacturing Exception

Examples

- Example 5 – Facts: CFC owns the raw materials, work in process and finished goods at all times. CFC has, but does not exercise, the right to oversee and direct the manufacturing process. CFC owns sophisticated automated software that (without human intervention) takes orders, routes them to CM, orders raw materials, and performs quality control. CFC employs a small number of computer technicians who monitor the software and apply any patches or fixes needed to keep the software running smoothly. Employees of the US parent corporation, USP, supervise the computer technicians, evaluate the results of the automated system, and make ongoing operational decisions. USP employees develop and update the automated software. USP employees 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 USP employees to direct the activities of CFC employees and otherwise contribute directly to the manufacturing process shows that substantial operational responsibilities and decision making are required to be exercised by parties other than CM in order to manufacture Product X.

Result: CFC does not satisfy the substantial contribution test for the CFC manufacturing exception.

Note: Mere ownership of materials and IP along with contractual rights to exercise powers of direction and control are not considered in the substantial contribution test for the CFC manufacturing exception.

Examples of the Concept (cont'd)

Substantial Contribution Test for CFC Manufacturing Exception

Examples

- Example 6 – Facts: Same as in Example 5, except CFC, through its employees, engages in the activities undertaken by USP's employees in Example 5. In addition, USP employees contribute to product and manufacturing process design, and provide support and oversight to CFC in connection with activities performed by CFC through its employees.

Result: CFC satisfies the substantial contribution test for the CFC manufacturing exception. This determination does not require comparing the activities of CFC and the activities of USP.

Note: If individuals are employees of both CFC and USP simultaneously, examiners should ascertain whether activities the individuals are duplicative of their responsibilities as employees of USP.

Examples of the Concept (cont'd)

Substantial Contribution Test for CFC Manufacturing Exception

Examples

- Example 7 – Facts: Same as in Example 6, except CFC purchased the software and upgrades rather than developing the software and upgrades through its own employees.

Result: CFC satisfies the substantial contribution test for the CFC manufacturing exception. The lack of performance of the software development activities is not determinative under the facts and circumstances of the business. This determination does not require comparing the activities of CFC and the activities of USP.

Note: Examples 5, 6 and 7 demonstrate that a CFC may provide a substantial contribution to a largely automated manufacturing process through its employees in cases in which substantial operational responsibilities and decision making by humans are required for the manufacturing process if the CFC, through its employees, actually performs those activities. The evaluation of whether a CFC makes a substantial contribution through its employees is determined based on whether industry-sufficient substantial contribution activities are conducted by employees of the CFC (Note: the assistance of an Engineer will be an important factor in making this determination).

Examples of the Concept (cont'd)

Substantial Contribution Test for CFC Manufacturing Exception

Examples

- Example 8 – Facts: CFC, through its employees, controls the raw materials, work in process and finished goods at all times; controls manufacturing related logistics; manages the manufacturing costs and capacities; and provides quality control with respect to CM's manufacturing process and product. The manufacture of Product X does not require any IP of significant value. CFC does not own any IP related to Product X or hold an exclusive or nonexclusive right to manufacture Product X.

Result: CFC satisfies the substantial contribution test for the CFC manufacturing exception.

Note: Since the use of IP plays little or no role in manufacturing Product X, it is not important in the substantial contribution analysis.

Examples of the Concept (cont'd)

Substantial Contribution Test for CFC Manufacturing Exception

Examples

- Example 9 – Facts: CFC1 and CFC2 (unrelated CFCs) contract with unrelated CM to manufacture Product X. Neither CFC1 nor CFC2 owns raw materials or work in process during the manufacturing process. Employees of CFC1 design Product X and direct the use of the product design and design specifications and other IP related to the manufacture of Product X. Employees of CFC1 also select the materials and vendors. Employees of CFC2 design the process for manufacturing Product X and manage the manufacturing costs and capacities. CFC1 and CFC2, through their employees, each provide quality control and oversight and direction of CM's manufacturing activities with respect to different aspects of the manufacture of Product X.

Result: CFC1 and CFC2 each independently satisfy the substantial contribution test for the CFC manufacturing exception.

Note: The fact that other persons make a substantial contribution does not preclude a CFC from making a substantial contribution to manufacturing. Each CFC takes into account the activities of its own employees, and no threshold level of activity is required before CFC1 and CFC2 can take into account their respective activities.

However, there IS a threshold level of activity required in order to satisfy the substantial contribution test for the CFC manufacturing exception. Remember, the evaluation of whether a CFC makes a substantial contribution through its employees is determined based on whether industry-sufficient substantial contribution activities are conducted by employees of the CFC. Each activity performed by a CFC's employees that contributes directly to the manufacture of the personal property at issue will be taken into account, regardless of how minimal the activity may be on its own. Then, all CFC employee activities directly contributing to the manufacture of the personal property are considered in the aggregate, and if the activities in the aggregate are sufficient to constitute a substantial contribution to the manufacture of that particular product, the CFC will satisfy the substantial contribution test for the CFC manufacturing exception.

Examples of the Concept (cont'd)

Substantial Contribution Test for CFC Manufacturing Exception

Examples

- Example 10 – Facts: Products in the X industry are distinguished (and vary widely) based on the raw materials used and the product design. CFC, through its employees, designs the product and selects the materials that CM will use to manufacture Product X. CFC also manages the manufacturing costs and capacities. Product X can be manufactured from the raw materials to CFC's specifications without significant oversight and direction, quality control, or control of manufacturing related logistics. The activities most relevant to the substantial contribution analysis under these facts are material selection, product design, and management of the manufacturing costs and capacities.

Result: CFC satisfies the substantial contribution test for manufacturing.

Note: In Example 10, any activities performed by CFC with respect to oversight and direction of the manufacturing, quality control, or control of manufacturing related logistics would be taken into account in determining whether CFC made a substantial contribution to manufacturing, but they would be given very little weight because Product X can be manufactured from the raw materials to CFC's specifications without such activities.

Examples of the Concept (cont'd)

Substantial Contribution Test for CFC Manufacturing Exception

Examples

- Example 11 – Facts: CFC, through its employees, controls the raw materials, work in process and finished goods; manages the manufacturing costs and capacities; and provides oversight and direction of the manufacture of Product X by CM. CFC employees visit CM's manufacturing facility for one week each quarter and perform quality control tests. In the X industry, quarterly visits by qualified individuals are sufficient to control the quality of manufacturing.

Result: CFC satisfies the substantial contribution test for manufacturing.

Note: The result in Example 11 could be different in an industry in which controlling the quality of manufacturing requires lengthier or more frequent visits by the CFC's employees. For example, quarterly week-long visits may be sufficient to control the quality of manufacturing a certain kind of commoditized goods, but may not be sufficient to control the quality of manufacturing for of high-precision, specialized goods . Likewise, the individuals purportedly performing the activities must be qualified to do so. For example, quarterly week-long visits by accounting personnel would not contribute directly to manufacturing.

Training and Additional Resources

Substantial Contribution Test for CFC Manufacturing Exception	
Type of Resource	Description(s)
Saba Meeting Sessions	<ul style="list-style-type: none">▪ Subpart F and the Substantial Contribution Rules August 2013 (VNN789444)▪ Foreign Base Company Sales Income (CJP011158)
Issue Toolkits	
White Papers / Guidance	
Podcasts / Videos	
Articles	
Databases / Research Tools	
Reference Materials – Treaties	
Other Training Materials	

Glossary of Terms and Acronyms

Term/Acronym	Definition
CFC	Controlled foreign corporation
CM	Contract manufacturer
FBCI	Foreign base company income
FBCSI	Foreign base company sales income
IP	Intellectual property
USP	US parent

Index of Related Practice Units

Associated UIL(s)	Related Practice Unit	DCN
9412	Subpart F Overview	DPL/C/02-01 (formerly DPL/CU/V_2_01(2013))
9412.01	Concepts of FBCSI	DPL/C/02_01-01 (formerly DPL/CU/P_2.1_11(2015))
9412.06	Conducting Functional Analysis for FBCI	DPL/P/02_06-01 (formerly DPL/PUO/P_2.6_12 (2015))
9412.01-02	Branch Rules for FBCSI	DPL/C/02_01_02-01 (formerly DPL/CU/C_2.1.2_07(2015))