

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

Number: **201340010**
Release Date: 10/4/2013
Index Number: 954.03-00

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:INTL:B02
PLR-150101-12

Date:
June 17, 2013

TY:

Legend

Taxpayer =
EIN =

FC =
EIN =

DE1 =
DE2 =

State =
Country =

General Products =

Stage A Products =
Stage B Products =
Stage C Products =

Dear _____ :

This is in response to a letter dated November 19, 2012, submitted by your authorized representative that requested a ruling on behalf of Taxpayer with respect to certain income derived by FC from the sale of Final Stage Products (defined herein). The ruling contained in this letter is based upon information and representations submitted on behalf of Taxpayer by its authorized representative, and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of this request for ruling, such material is

subject to verification on examination. The information submitted in the request is substantially as set forth below.

FACTS:

Taxpayer is a corporation organized under the laws of State. Taxpayer, along with its subsidiaries, is a leading global provider of General Products. Taxpayer indirectly wholly owns FC, an entity that was formed under the laws of Country that is treated as a corporation for Federal income tax purposes. FC wholly owns DE1, an entity that was formed under the laws of Country that is disregarded as an entity separate from its owner for Federal income tax purposes. DE1, in turn, wholly owns DE2, an entity that was formed under the laws of Country that is disregarded as an entity separate from its owner for Federal income tax purposes. FC, DE1 and DE2 collectively are referred to as FC Group.

FC is treated as a controlled foreign corporation (CFC) within the meaning of section 957(a) of the Internal Revenue Code. A domestic subsidiary wholly owned by Taxpayer and included in the U.S. consolidated return of Taxpayer is the direct U.S. shareholder, within the meaning of section 951(b), with respect to FC.

FC Group produces Final Stage Products in a process that consists of four phases. During the initial phase, FC makes decisions as to the types of product traits that are needed to meet market demand and provide market opportunities. FC then enters into cost-plus arrangements with related persons and unrelated persons for research and development, as a result of which intellectual property is developed for the risk and account of FC, and ultimately the Stage A Products are developed.

During the second phase, the Stage B Products are produced from the Stage A Products. FC Group either contracts with related persons or unrelated persons under either contract manufacturing or toll manufacturing arrangements to produce the Stage B Products in jurisdictions outside of Country, or produces the Stage B Products directly in Country or in jurisdictions outside of Country. Specifically, the Stage A Products are planted, and the Stage B Products are harvested from the resulting crop grown from the Stage A Products. If a contract manufacturing arrangement is used, FC Group may transfer title of the Stage A Products to the contracting party in exchange for a nominal amount. Thus, during the growing and harvesting processes, legal title to the Stage B Products is held either by FC Group or by the contracting party. In cases where title is transferred to the contracting party, title to the Stage B Products is subsequently transferred for a nominal amount to FC Group, and the contracting party is remunerated by FC Group through a fee.

During the third phase, the Stage C Products are produced from the Stage B Products. FC Group either contracts with related persons or unrelated persons under either contract manufacturing or toll manufacturing arrangements to produce the Stage C

Products in jurisdictions outside of Country, or produces the Stage C Products directly in Country or in jurisdictions outside of Country. Specifically, the Stage B Products are planted, and the Stage C Products are harvested from the resulting crop grown from the Stage B Products. If a contract manufacturing arrangement is used, FC Group may transfer title of the Stage B Products to the contracting party in exchange for a nominal amount. Thus, during the growing and harvesting processes, legal title to the Stage C Products is held either by FC Group or by the contracting party. In cases where title is transferred to the contracting party, title to the Stage C Products is subsequently transferred for a nominal amount to FC Group, and the contracting party is remunerated by FC Group through a fee.

During the fourth phase, the Stage C Products are organized at processing facilities for final cleaning, quality assessment and packaging based on relevant marketing requirements. FC Group either performs these activities directly, or contracts with a related person to perform these activities in a jurisdiction outside of Country in exchange for a fee. At the conclusion of the fourth phase, the Stage C Products are in the form in which they eventually are sold (“Final Stage Products”).

After the fourth phase, FC Group sells the Final Stage Products to related persons and unrelated persons for use in jurisdictions inside and outside of Country.

REPRESENTATIONS

Taxpayer makes the following representation:

FC’s activities with respect to the Final Stage Products constitute production for purposes of Treas. Reg. §1.954-3(a)(4) if activities that are both growing and production activities are taken into account in determining whether a CFC has “produced” property for purposes of Treas. Reg. §1.954-3(a)(4).

RULING REQUESTED:

Production activities that also are growing activities are taken into account for purposes of determining whether FC has produced the Final Stage Products for purposes of Treas. Reg. §1.954-3(a)(4)(i).

LAW:

Section 951(b) defines a U.S. shareholder, with respect to any foreign corporation, as a United States person (as defined in section 957(c)) who owns (directly, indirectly or constructively) 10 percent or more of the total combined voting power of all classes of stock entitled to vote of the foreign corporation. (“U.S. Shareholder”).

Section 957(a) defines a CFC as a foreign corporation with respect to which more than 50 percent of the total combined voting power of all classes of stock entitled to vote or the total value of the stock of the corporation is owned (directly, indirectly or constructively) by U.S. Shareholders.

Generally, section 951(a) provides that if a foreign corporation is a CFC for a period of thirty days or more during any taxable year, a U.S. Shareholder of the CFC must include in gross income its pro rata share of the CFC's subpart F income.

Section 952(a)(2) defines subpart F income to include foreign base company income ("FBCI").

Section 954(a)(2) defines FBCI to include foreign base company sales income ("FBCSI") as defined in section 954(d).

Section 954(d)(1) defines FBCSI to mean income (whether in the form of profits, commissions, fees, or otherwise) derived in connection with the purchase of personal property from a related person and its sale to any person, the sale of personal property to any person on behalf of a related person, the purchase of personal property from any person and its sale to a related person, or the purchase of personal property from any person on behalf of a related person where (A) the property which is purchased (or in the case of property sold on behalf of a related person, the property which is sold) is manufactured, produced, grown or extracted outside the country under the laws of which the CFC is created or organized, and (B) the property is sold for use, consumption or disposition outside the foreign country, or, in the case of property purchased on behalf of a related person, is purchased for use, consumption or disposition outside the foreign country.

Section 954(d)(3) provides that a person is a related person with respect to a CFC if: (A) the person is an individual, corporation, partnership, trust or estate which controls, or is controlled by, the CFC; or (B) the person is a corporation, partnership, trust or estate which is controlled by the same person or persons that control the CFC. Control is defined as the direct or indirect ownership of more than 50 percent of the total voting power of all classes of stock entitled to vote or the total value of a corporation, or more than 50 percent of the beneficial interest in a partnership, trust or estate.

Treas. Reg. §1.954-3(a)(1)(i) provides that FBCSI of a CFC, except as provided in Treas. Reg. §1.954-3(a)(2), (a)(3) and (a)(4), consists of gross income (whether in the form of profits, commissions, fees or otherwise) derived in connection with the purchase of personal property from a related person and its sale to any person, the sale of personal property to any person on behalf of a related person, the purchase of personal property from any person and its sale to a related person, or the purchase of personal property from any person on behalf of a related person.

Treas. Reg. §1.954-3(a)(4)(i) provides that FBCSI does not include income of a CFC derived in connection with the sale of personal property manufactured, produced or constructed by the corporation. A CFC will have manufactured, produced or constructed personal property which the corporation sells only if the corporation satisfies the provisions of Treas. Reg. §1.954-3(a)(4)(ii), (iii) or (iv) through the activities of its employees (as defined in Treas. Reg. §31.3121(d)-1(c)) with respect to the property.

Treas. Reg. §1.954-3(a)(4)(ii) provides that if personal property purchased by a foreign corporation is substantially transformed by the foreign corporation prior to sale, the property sold by the selling corporation is manufactured, produced or constructed by the selling corporation.

Treas. Reg. §1.954-3(a)(4)(iii) provides that if purchased property is used as a component part of personal property that is sold, the sale of the property will be treated as the sale of a manufactured product, rather than the sale of component parts, if the assembly or conversion of the component parts into the final product by the selling corporation involves activities that are substantial in nature and generally considered to constitute the manufacture, production or construction of property.

Treas. Reg. §1.954-3(a)(4)(iv) provides that if an item of personal property would be considered manufactured, produced or constructed (under the principles of Treas. Reg. §1.954-3(a)(4)(ii) or (a)(4)(iii)) prior to sale by the CFC had all of the manufacturing, producing and constructing activities undertaken with respect to that property prior to sale been undertaken by the CFC through the activities of its employees, then Treas. Reg. §1.954-3(a)(4)(iv) applies. If Treas. Reg. §1.954-3(a)(4)(iv) applies and if the facts and circumstances evince that the CFC makes a substantial contribution through the activities of its employees to the manufacture, production or construction of the personal property sold, then the personal property sold by the CFC is manufactured, produced or constructed by the CFC.

ANALYSIS:

Taxpayer's domestic subsidiary is a U.S. Shareholder with respect to FC, which is a CFC. Thus, the domestic subsidiary is required to include amounts in income under section 951(a)(1) with respect to FC, including its pro rata share of FC's subpart F income, which includes FBCSI. Unless an exception applies, FBCSI includes income derived in connection with the purchase of personal property from any person and its sale to a related person, and the purchase of personal property from a related person and its sale to any person.

Unless the exception provided in Treas. Reg. §1.954-3(a)(4) ("manufacturing exception") applies, certain income that FC derives from the sale of the Final Stage Products meets the definition of FBCSI because the income is derived in connection

with the purchase of personal property from a related person, or a sale of personal property to a related person. Treas. Reg. §1.954-3(a)(4)(i) provides that a CFC can rely on the manufacturing exception only if it satisfies the provisions of Treas. Reg. §1.954-3(a)(4)(ii) through (iv). Thus, for example, the manufacturing exception applies with respect to income derived from sales of: (i) Final Stage Products that FC produces directly in the second phase and third phase if FC satisfies the provisions of Treas. Reg. §1.954-3(a)(4)(ii) or (iii) with respect to the Final Stage Products; and (ii) Final Stage Products that are produced pursuant to contract manufacturing arrangements in the second phase or third phase if FC satisfies the provisions of Treas. Reg. §1.954-3(a)(4)(iv) with respect to the Final Stage Products.

Treas. Reg. §1.954-3(a)(4)(i) does not specifically address whether income derived from the sale of personal property grown by a CFC is excluded from FBCSI pursuant to the manufacturing exception. However, Treas. Reg. §1.954-3(a)(4)(i) does provide that the manufacturing exception applies to income derived in connection with the sale of personal property “manufactured, produced or constructed” by the CFC. The terms “produced” and “grown” are not interchangeable. However, the use of the term “grow” to describe a process or part of a process is not determinative of whether the process constitutes a production activity. Based on facts and circumstances, certain growing activities also may constitute production activities for purposes of Treas. Reg. §1.954-3(a)(4). The omission of the term “grown” from Treas. Reg. §1.954-3(a)(4) does not preclude growing activities that also are production activities from being taken into account in determining whether a CFC satisfies the provisions of Treas. Reg. §1.954-3(a)(4)(ii) through (iv). Rather, the manufacturing exception applies to the extent that income is derived from the sale of property produced by a CFC, even if the relevant production activities include growing activities.

Accordingly, FC Group’s activities related to the physical growing of the Stage B Products and Stage C Products that constitute production activities are taken into account in determining whether FC produced the Final Stage Products for purposes of applying the manufacturing exception to the income derived from the sale of the Final Stage Products. In addition, the activities related to the physical growing of Stage B Products and Stage C Products that constitute production activities that are undertaken by contract manufacturers are taken into account in determining whether FC produced the Final Stage Products for purposes of applying the first sentence of Treas. Reg. §1.954-3(a)(4)(iv)(a).

RULING:

Production activities that also are growing activities are taken into account for purposes of determining whether FC has “produced” the Final Stage Products for purposes of Treas. Reg. §1.954-3(a)(4)(i) through (iv). Activities undertaken directly by FC Group are taken into account for purposes of Treas. Reg. §1.954-3(a)(4)(i) through (iv), and activities undertaken by contract manufacturers are taken into account for purposes of

applying the first sentence of Treas. Reg. §1.954-3(a)(4)(iv)(a). Thus, based on the information submitted and the representations made, including the representation that FC's activities with respect to the Final Stage Products constitute production for purposes of Treas. Reg. §1.954-3(a)(4) if activities that are both growing and production activities are taken into account in determining whether a CFC has "produced" property for purposes of Treas. Reg. §1.954-3(a)(4), the income derived by FC from the sale of Final Stage Products produced by FC that otherwise is FBCSI is excluded from FBCSI pursuant to Treas. Reg. §1.954-3(a)(4)(i).

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically no opinion is expressed concerning whether any activities of the employees of FC Group constitute production activities or whether the activities, in the aggregate, performed with respect to Final Stage Products constitute production for purposes of Treas. Reg. §1.954-3(a)(4)(i).

This private letter ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter ruling is being sent to your authorized representative.

A copy of this letter ruling must be attached to any federal income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

Sincerely,

Jeffery G. Mitchell
Branch Chief, Branch 2
(International)

cc: