

Internal Revenue Service

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Person To Contact:

ID No.

Telephone Number:

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Date:

July 14, 2021

LEGEND

X =

Fabricator =

License Agreement =

Supply Agreement =

Period =

Dear _____ :

This letter responds to a letter ruling request dated January 9, 2021, submitted on your behalf by your authorized representative, requesting a ruling under § 4161(a) of the Internal Revenue Code (the Code).

FACTS

According to the facts submitted, X designs, markets, and sells fishing reels (“Reels”). X owns intellectual property relating to the mechanical architecture and manufacture of Reels, including issued utility patents, pending utility patent applications, and certain know-how owned by X (collectively, “X Intellectual Property”).

X has entered into License Agreement and Supply Agreement with Fabricator pursuant to which Fabricator fabricates Reels based on X's specifications. Fabricator and X are unrelated entities and the arrangement between them is the result of arm's length negotiations.

Under the terms of License Agreement, X grants Fabricator a license to use X Intellectual Property to fabricate and sell Reels in the United States. Fabricator may use X Intellectual Property to fabricate and sell Reels to third-party customers in the United States, but only if such Reels do not contain X's logo, trademark, tradenames, or aesthetic design elements ("X Identifiers"). For each Reel sold by Fabricator to third-party customers, Fabricator must pay X a license fee. Fabricator can only use X Identifiers on Reels it fabricates and sells to X, and only if it has X's permission to do so. During the term of License Agreement, the intellectual property license is irrevocable.

Supply Agreement outlines the terms pursuant to which Fabricator fabricates Reels for sale to X and may fabricate Reels for sale to third-party customers. Under the terms of Supply Agreement, Fabricator must obtain materials required to fabricate and package Reels, including all raw materials, programmable logic controllers and associated programming, Fabricator tools, components, and packaging materials. The fabrication of Reels requires special tools and molds that are expensive. Supply Agreement requires X to purchase such special tooling and molds (collectively "X Tooling") and permits Fabricator to use X Tooling to fabricate Reels for X and third-party customers pursuant to the terms of License Agreement. For each Reel that Fabricator fabricates using X Tooling but sells to third-party customers, Fabricator must pay X a user fee. Fabricator owns all other tools, equipment, and molds it needs to fabricate Reels. Pursuant to Supply Agreement, Fabricator will fabricate all Reels at its facility in the United States.

The price at which Fabricator sells Reels to X is determined by X and Fabricator every Period. Once the price is determined, it is not adjusted based on the fabrication cost of Fabricator. Accordingly, Fabricator bears the risk of loss if the production costs go up and keeps the profits if the production costs go down during that time. Fabricator decides, in its sole discretion, how many Reels it fabricates each year and to whom it sells Reels. X does not have the exclusive or first right to purchase Reels fabricated by Fabricator. After X issues a purchase order for Reels, Fabricator decides whether to accept the purchase order at Fabricator's sole discretion.

RULING REQUESTED

X is not the manufacturer, producer, or importer of Reels for purposes of the tax imposed by § 4161(a) of the Code.

LAW

Section 4161(a)(1) of the Code imposes a 10 percent tax on the sale of any article of sport fishing equipment by the manufacturer, producer, or importer.

Section 4162(a)(2) provides that the term "sport fishing equipment" includes fishing reels.

Section 48.4161-1(c) of the Manufacturers and Retailers Excise Taxes Regulations provides that the tax imposed by § 4161(a) is payable by the manufacturer, producer, or importer making the sale.

Section 48.0-2(a)(4)(i) provides that the term “manufacturer” includes any person who produces a taxable article from scrap, salvage, or junk material or from new or raw material, by processing, manipulating, or changing the form of an article or by combining or assembling two or more articles. The term also includes a “producer” and an “importer.”

Section 48.0-2(a)(4)(ii) provides that under certain circumstances, as where a person manufactures or produces a taxable article for another person who furnishes materials under an agreement whereby the person who furnished the materials retains title thereto and to the finished article, the person for whom the taxable article is manufactured or produced, and not the person who actually manufactures or produces it, will be considered the manufacturer.

Rev. Rul. 58-134, 1958-1 C.B. 395, holds that a company that owns the patents under which a taxable article is fabricated by another company, exercises control as to the amounts to be fabricated, has exclusive rights or first rights to the output, and designates territories where the fabricator may sell the article is considered to be the manufacturer for purposes of the manufacturers excise tax on those articles the company sells.

Rev. Rul. 60-42, 1960-1 C.B. 474, holds that among the factors to be considered in determining whether a fabricator or the vendee is liable for the manufacturers excise tax are (1) the ownership of the raw materials used in producing the articles, and (2) the right to control the production and sale of the articles.

Rev. Rul. 76-181, 1976-1 C.B. 341, holds that where (1) a fabricator owns the materials, tools, dies, machinery, and equipment used to manufacture a product and can produce and sell the articles anywhere (except that articles with the trademark or trade name of the customer can only be sold to the customer), (2) the fabricator has an unlimited, nonexclusive, and irrevocable license to use the customer's patents in the production process, and (3) the customer does not have the exclusive or first right to the output of the fabricator's products under the patent license, the fabricator is the manufacturer liable for the excise tax on all sales of the article produced by fabricator.

Rev. Rul. 78-34, 1978-1 C.B. 355, holds, generally, that where a company not only owns the patents under which a taxable article is fabricated by another company, but also exercises control as to the amounts to be so fabricated and has exclusive rights to the output so that the fabricator is not free to sell elsewhere, the company owning the patents is the manufacturer for purposes of the manufacturers excise tax.

In Polaroid Corp. v. U.S., 235 F.2d 276 (1st Cir. 1956), cert. denied, 352 U.S. 953 (1956), a taxpayer contracted with a fabricator to produce taxable cameras for which the taxpayer had a patent. The appellate court held that the taxpayer was the manufacturer of the cameras because the taxpayer bought the fabricator's entire output, dictated the amount of the output, prohibited the fabricator from selling the cameras to anyone but the taxpayer, bore the risk of a production cost increase, benefitted if production costs dropped, and owned specialized tools. Additionally, the fabricator did not pay the taxpayer royalties for the patented cameras, which both the appellate court and the trial court found to be of particular significance.

ANALYSIS & CONCLUSION

At issue is whether X is the manufacturer, producer, or importer of Reels for purposes of the tax imposed by § 4161(a).

Fabricator fabricates Reels in the United States. Fabricator owns all raw materials, tools (other than X Tooling), machinery, and equipment used to fabricate Reels. Fabricator decides at its sole discretion how many Reels it fabricates each year and whether it wants to sell any Reels to X. X does not have the exclusive or first right to purchase Reels produced by Fabricator. Further, Fabricator bears the risk of loss if its production costs go up and keeps the profits if its production costs go down during the period between price determinations.

In addition, Fabricator can, without seeking any permission from X, use X Intellectual Property and X Tooling to fabricate and sell Reels to anyone in the United States as long as Fabricator pays X a license fee for the use of X Intellectual Property and a user fee for the use of X Tooling, and otherwise satisfies the requirements of License Agreement and Supply Agreement.

Based on the foregoing, we conclude that X is not the manufacturer, producer, or importer of the Reels for purposes of the tax imposed by § 4161(a). See Polaroid, Rev. Rul. 58-134, Rev. Rul. 60-42, and Rev. Rul. 78-34.

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.

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

This private letter ruling is based upon information and representations submitted by X 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 the request for a ruling, the supporting material is subject to verification or examination.

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

Sincerely,

/s/

Stephanie Bland
Branch Chief, Branch 7
Office of Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)
Copy of this letter
Copy for § 6110 purposes

cc: