

**Manufacturing Exception to FBCSI --
Growing Activities Can Be Production Activities**

FC is a Country X Corporation that is wholly owned indirectly by Taxpayer, a U.S. Corporation. FC is a controlled foreign corporation ("CFC"). FC and its two wholly owned disregarded entities ("FC Group") produce Final Stage Products for sale to related and unrelated buyers. Production of the Final Stage Products requires the planting, growing, and harvesting of crops.

Unless the exception provided in Treas. Reg. §1.954-3(a)(4) ("manufacturing exception") applies, a portion of the income that FC derives from the sale of the Final Stage Products meets the definition of Foreign Base Company Sales Income ("FBCSI") because the income is derived in connection with the sale of personal property to a related person.

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.

Based on 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).

