INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

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Taxpayer's Name:
Taxpayer's Address:

Taxpayer's Identification No
Year(s) Involved:
Date of Conference:

LEGEND

Taxpayer =
Customer =
Firm1 =
IndustryQ =
Industry AssocationA =

Taxable Year1 =
Taxable Year2 =
Taxable Year3 =

Taxable Year4 =

ComponentX =

ComponentXX =
SuperComponentX =
Final ProductX =
SubComponent1 =
SubComponent2 =
SubComponent3 =
SubComponent4 =
SubComponent5 =

SubComponent6 =
SubComponent7 =
SubComponent8 =
SubComponent9 =

Fastener1 =
Fastener2 =
Fastener3 =
Fastener4 =
Fastener5 =

Part1 =
Part2 =
Part4 =
Part3 =

Location1 =

Location2 =

Amount1 =
Amount2 =
Amount3 =
Amount4 =
Amount5 =

Customer’s Facility =

AgreementA =

AgreementB =

I. ISSUE

Whether Taxpayer's component part described in this memorandum is precluded by Temp. Treas. Reg. § 1.927(a)-1T(d)(2)(iii) from qualifying as export property.

II. CONCLUSION

Yes. Taxpayer's component part described in this memorandum is precluded by Temp. Treas. Reg. § 1.927(a)-1T(d)(2)(iii) from qualifying as export property.

III. FACTS

Taxpayer is a domestic corporation that manufactures and sells ComponentX to Customer for installation and use as a component of Final ProductX. Taxpayer manufactures ComponentX in the United States, and Customer installs ComponentX in Final ProductX in the United States before Customer delivers Final ProductX to end-users outside the United States. One ComponentXX[1] consists of Amount1[2] subcomponents. To summarize, Taxpayer makes and sells the ComponentX, which consists of a number of subcomponents and is, itself, a component of the Final ProductX made and sold by Customer.

A. Sale Terms

Taxpayer and Customer entered into a Purchase Agreement that, as we understand it, consists of at least two documents, one of which ("AgreementA") incorporates the other ("AgreementB") by reference. See, AgreementA, § . Under the Purchase Agreement, Customer agreed to purchase a minimum of Amount2 ComponentXX from Taxpayer for $Amount3 per ComponentXX. Id. at § . ComponentXX consists of 9 types of subcomponents -- SubComponents1 through 9.[3]

[1] "ComponentX" and "ComponentXX" are alternate (depending on the context) ways of referring to the integrated system of subcomponents that is the subject of this memorandum.

[2] We understand that some versions of a ComponentXX consist of more or fewer than Amount1 subcomponents and that all versions are materially similar for purposes of the legal question addressed in this memorandum.

Id. at The Purchase Agreement lists the price for each subcomponent of one ComponentXX (totaling $Amount3 in the aggregate) and also specifies the $Amount3 total sale price for each ComponentXX. Id. at §

.

In addition to the minimum Amount2 ComponentXX initial order, Customer may also purchase additional ComponentXX and ComponentX subcomponents under the Purchase Agreement. Section of AgreementA states: "An initial Order will be placed ." Section provides, in part:

.

Section of AgreementA, which is under the provision, states:

.

Section of AgreementA provides:

.

The Purchase Agreement also contains terms regarding orders and shipments. For example,

. . . .

AgreementA, § . We understand that Buyer issues invoices, pays, and accounts for each ComponentX subcomponent separately.

. But see also

The Purchase Agreement refers to ComponentX as “ ” and “ .” of AgreementA defines “ ” as ComponentX. Other provisions of AgreementA refer to the “ .” Section of AgreementB defines “ ,” in relevant part, as “ . . . .” Section of AgreementB provides:

In other words, if the terms in AgreementA and AgreementB are inconsistent, the AgreementA terms control. The Purchase Agreement requires Customer to purchase Amount2 (i.e., complete Final ProductX) and provides for the purchase of additional ComponentX and ComponentX subcomponents.

Taxpayer claims that it warrants each ComponentX subcomponent to the end-user and that the parts are turned in to Taxpayer for warranty servicing. However, Section of AgreementA states:

[4]

.

[4] “ ” means “ .”

Generally, Taxpayer directs its marketing, negotiating, and soliciting activities with respect to ComponentX towards customers, rather than towards the end-users of Final ProductX and other products that incorporate Taxpayer-made component parts such as ComponentX. Taxpayer claims that it directs some marketing activities toward end-users in that Taxpayer attempts to generate interest in its products among end-users that might then pressure manufacturers, such as Customer, to include Taxpayer-made components in their final products. However, Taxpayer provided no evidence that it performed such purported marketing activities in connection with the sales at issue in this case.[5] Taxpayer does not claim that it solicited contracts or negotiated terms of sale regarding ComponentXX with the end-users; in fact, Taxpayer did not engage in such activities.

B. Installation

Some ComponentX subcomponents are installed in the Location1 of the Final ProductX; the rest are installed in the Location2 of the Final ProductX. Amount4 SubComponent1 are installed in the Location1 secured by Fastener1. After SubComponent1 is installed, Part1 (supplied by Customer) are installed and connected to SubComponent1. No tools are required to install or remove SubComponent2. Up to Amount5 SubComponent2 slide into the front of each SubComponent1. Each SubComponent2 is secured to SubComponent1 by Part2. Customer's personnel who install SubComponents1 and 2 and attach Part1 . Some SubComponent9 are installed in the SubComponent2 at Taxpayer's plant before shipment to Customer's Facility. Additional SubComponent9 are usually installed in ComponentX during or after installation of the other ComponentX subcomponents in Final ProductX.

The remainder of the ComponentX is installed in the Location2. SubComponent3 are installed by matching Fastener2 with Part3 and then securing the SubComponent3 with Part4 and using Fastener3 to secure SubComponent3 in place. Part4 aid in installation and extraction of the SubComponent3. SubComponent4, a SubComponent7, and SubComponent8 are secured with Fastener4. The SubComponents5 and 6 are secured using Fastener5. Like most or all components and subcomponents of Final ProductX, the ComponentX subcomponents can be removed and replaced without damaging or destroying Final ProductX. Such design ensures that a failure of ComponentX does not render Final ProductX unusable.

C. Legal Factors Identified by Taxpayer

Taxpayer asserts generally that the

[5] Taxpayer was able only to make the unsupported claim that manufacturers such as Customer are sometimes annoyed by Taxpayer's attempts to influence their component-purchasing practices by generating interest in Taxpayer's component parts among end-users.

regulations in support its assertion that

such as ComponentX is treated as legally separate (similar to the engines in GE). Relying on , Taxpayer asserts specifically in its position paper that each ComponentX subcomponent is . In Taxpayer's view, such treatment is necessary because the ComponentX subcomponents are not associated with just one Final ProductX but rather, in general, are likely to spend the majority of their lives on a Final ProductX other than the one into which they are installed as original equipment. See, Taxpayer's Supplemental Factual Memorandum for the Internal Revenue Service, p. 4. Taxpayer also cites some Service publications in support of its argument that ComponentX is legally separate and distinct from Final ProductX.

D. Taxpayer's Position

On its original income tax returns for Taxable Years1 through 4, Taxpayer did not claim foreign sales corporation ("FSC") benefits with respect to sales of ComponentX because Taxpayer believed that ComponentX did not qualify as export property under Temp. Treas. Reg. § 1.927(a)-1T(d)(2)(iii). Following the decision in General Electric Co. and Subs. v. Commissioner, 245 F.3d 149 (2nd Cir. 2001), acq. in result, AOD 2003-04, 2003-2 C.B. xxiii, 2003 AOD LEXIS 1 (2003), and based on advice from Firm1, Taxpayer amended its returns for those years, claiming FSC benefits on its sales of ComponentXX covered by the Purchase Agreement.

IV. LAW

A. The Component Parts Test

Sections 921(a), 923, and 924(a)(1) of the FSC provisions provide a partial income tax exemption with respect to sales of export property. Property constitutes export property only if, among other things, it is "held primarily for sale, lease, or rental, in the ordinary course of trade or business, by, or to, a FSC, for direct use, consumption, or disposition outside the United States." I.R.C. § 927(a)(1)(B). Property is deemed to be sold for use outside the United States under section 927(a)(1)(B) if it satisfies, among other requirements, the destination test. Temp. Treas. Reg. § 1.927(a)-1T(d)(1)(i). Generally, the destination test requires that sold or leased property be delivered outside the United States in a specified manner within a specified time period following the sale or lease. Temp. Treas. Reg. § 1.927(a)-1T(d)(2)(i). A limitation on the destination test, known as the component parts test, further provides:

> In no event is the destination test of this paragraph satisfied with respect to property which is subject to any use (other

> than a resale or sublease), manufacture, assembly, or other processing (other than packaging) by any person between the time of the sale or lease by such seller and the delivery or ultimate delivery outside the United States described in this paragraph (d)(2).

Temp. Treas. Reg. § 1.927(a)-1T(d)(2)(iii). The applicability of the component parts test to sales of engines as equipment on commercial aircraft was litigated in GE, 245 F.3d 149, described below.[6]

B. The GE case

GE manufactured engines and sold them to airframe-makers. The airframe-makers hired contractors to attach the engines to the airframes. The airframe-makers then sold the completed aircraft to airlines for use outside the United States. At issue in GE was a single legal question: Whether engine attachment activities performed after sale but before delivery outside the United States constituted assembly and, thus, whether the component parts test was violated.[7] If engine attachment activities constituted assembly, the engines would not qualify as export property.

The Second Circuit Court of Appeals held that engine attachment activities did not constitute assembly within the meaning of the component parts test. GE, 245 F.3d at 151. The court reasoned that, because engines and airframes are separate and distinct from one another legally, physically, and contractually, the attachment of an engine to an airframe constitutes mere "affixing" of one item of export property to another. Legal separateness is reflected in the Federal Aviation Administration ("FAA") regulations and Service decisions. Id. at 157. Physical separateness (as compared with mere interchangeability) is embodied by the fact that engines are routinely removed from the airframe and placed in another airframe. Id. Contractual separateness is exemplified by the fact that GE marketed its products directly to the airlines (rather than the airframe-makers) and negotiated all material terms of sale with the airlines only. Id. at 157-158. As a result, the court determined that GE's engines (1) were not subject to assembly after sale, (2) did not violate the component parts test, and (3) thus constituted export property.

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[6] GE involved the domestic international sales corporation component parts test in Treas. Reg. § 1.993-3(d)(2)(iii), which is the materially similar predecessor of the FSC component parts test. Therefore, the analysis of Treas. Reg. § 1.993-3(d)(2)(iii) in GE applies to the FSC component parts test in Temp. Treas. Reg. § 1.927(a)-1T(d)(2)(iii). See also, AOD 2003-04.

[7] The Second Circuit Court of Appeals did not address the issue of whether the attachment of thrust reversers to an airframe also violates the component parts test.

The Service acquiesced only in the result of GE in an action on decision ("GE AOD"), which provides, in relevant part:

> [T]he 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.

AOD 2003-04, p.2.

C. Non-Tax Rules

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V. ANALYSIS

The application of the component parts test requires a one- or two-step analysis depending on the facts of the case. The first step is a determination of whether the component was subject to assembly within the United States after sale but prior to delivery outside the United States in violation of the component parts test. If such assembly did not occur, the inquiry is finished because the component parts test does not bar the property from qualifying as export property under section 927(a)(1)(B) and the destination test. However, if such assembly did occur, then a second step of the analysis is required – a determination of whether, for purposes of the component parts test, a component is treated as not subject to assembly if it remains separate and distinct from the product into which it is installed, as described in the GE appellate opinion. In the remainder of this memorandum, we apply this analysis to Taxpayer's facts and conclude that, under the component parts test as illuminated by GE, neither ComponentX nor its subcomponents constitute export property for purposes of the FSC provisions.

A. Step One

The component parts test of Temp. Treas. Reg. § 1.927(a)-1T(d)(2)(iii) provides, in relevant part, that property does not constitute export property if it is subject to assembly after sale but prior to delivery outside the United States. This rule, standing alone, would prevent ComponentX from qualifying as export property because each subcomponent of ComponentX is subject to assembly in Customer's Facility after sale to Customer but before delivery outside the United States.

Taxpayer asserts that installation activities performed with respect to ComponentX subcomponents do not constitute assembly and that such activities are similar to the activities at issue in a private letter ruling,

("the PLR"). In addition, Taxpayer claims that the PLR

ComponentX (or its individual subcomponents) is
Based on those assertions, Taxpayer argues that the installation of ComponentX does not constitute assembly under the component parts test.

We disagree with this argument for several reasons. First, the PLR is not precedential. It is a taxpayer- and case-specific written determination that, to the best of our knowledge, does not apply to Taxpayer. See I.R.C. § 6110(k)(3) ("a written determination may not be used or cited as precedent") and Rev. Proc. 2006-1, 2006-1 I.R.B. 1, 48, § 11.02 ("A taxpayer may not rely on a letter ruling issued to another taxpayer."). Second, the installation activities in Taxpayer's case satisfy any reasonable notion of "assembly." ComponentX consists of Amount1 subcomponents and is sold to another manufacturer which installs all subcomponents into Final ProductX and then sells Final ProductX (including ComponentX) to an end-user. Each subcomponent, other than SubComponent2, must be attached or secured to Final ProductX with Fastener1, Part1, Fastener4, Fasterner5, or other connecting devices. In short, ComponentX is subject to assembly within Final ProductX under the plain language of the component parts test and, in some instances, ComponentX subcomponents are even assembled into one another (in particular, SubComponents1 and 2).

Third, Taxpayer contends that the relevant sales under the Purchase Agreement were not sales of ComponentXX in the aggregate but, instead, the separate sales of each subcomponent of each ComponentXX. Therefore, the argument goes, each subcomponent, standing alone would not be considered subject to assembly because the installation activities for each individual subcomponent were relatively insubstantial.

Taxpayer and Field Counsel disagree whether the sales at issue here and covered by the Purchase Agreement were sales of complete ComponentXX or sales of the individual subcomponents of ComponentXX. Taxpayer contends that (1) because it issued invoices, made shipments, and accounted for ComponentX sales on a subcomponent-by-subcomponent basis, and (2) because Customer issued purchase orders and paid Taxpayer on a subcomponent-by-subcomponent basis, and (3) because the Purchase Agreement itemizes the ComponentXX total purchase price, each complete ComponentX corresponded to Amount2 separate sales of Amount2 separate items of export property.

Taxpayer also emphasizes the fact that it sells ComponentX subcomponents separately as spare parts. That is, suppose Taxpayer receives an order for a SubComponent5 to replace one that failed. In that case, the relevant property would be SubComponent5, not a ComponentX. Therefore, Taxpayer argues, a sale of a ComponentX must consist of multiple sales, including a sale of a SubComponent5.

Field Counsel argues that the Purchase Agreement applies, on its face, to the purchase of complete ComponentX. Field Counsel contends that Customer agreed to purchase ComponentX subcomponents on a complete ComponentXX basis, not on a subcomponent-by-subcomponent basis. Under this view, the presence of itemized prices in of the AgreementA does not change the fact that Taxpayer and Customer agreed to a sale of Amount2 complete ComponentXX at a price of $Amount3 per ComponentXX.

We agree with Field Counsel. The Purchase Agreement required Customer to purchase Amount2 ComponentXX -- no more and no less. AgreementA seems to contemplate that Customer may purchase spare parts (and additional ComponentXX) in addition to the required Amount2 ComponentXX. The Purchase Agreement also contemplates that each purchase order may specify either a single ComponentXX or multiple ComponentXX. In short, the references throughout AgreementA to " " in some instances and to " " in other instances are entirely consistent with a contract that covers an initial sale of complete ComponentXX (subject to multiple purchase orders of varying size) as well as potential additional sales of ComponentXX and ComponentX subcomponents.

We also believe that the AgreementB references to " " are generally consistent with the usage of similar terms in AgreementA. Nonetheless, to the extent that such references in AgreementA may be viewed as inconsistent with corresponding references in AgreementB, AgreementA controls. See AgreementB, § . We believe the AgreementB definition of " " supports Field Counsel's reading of the Purchase Agreement. That is, " " generally refers to a ComponentXX but may also under certain circumstances (such as an order for a spare ComponentX subcomponent) refer to an individual ComponentX subcomponent. This case involves only the initial sale of Amount2 ComponentXX. In short, we believe that the plain language of Taxpayer's terms of sale demonstrates that Taxpayer sold ComponentXX, rather than subcomponents of ComponentX.[8]

The component parts test applies to ComponentXX in the aggregate, not to each subcomponent. Also, we disagree with Taxpayer's spare part example. The determination of the property that is the subject of a sale depends on the terms of that particular sale, not the terms of some other sale. The fact that Taxpayer also sells spare subcomponents does not support Taxpayer's conclusion that the sale of a ComponentX consists of separate sales of each subcomponent. On the contrary, that conclusion would require us to disregard the terms of sale (i.e., sales of complete ComponentXX) contained in the Purchase Agreement.

[8] Specifically, we believe the Purchase Agreement describes a single initial transaction – a single sale of Amount2 ComponentXX -- but may also give rise to additional transactions depending on Customer's requirements.

Assuming it were possible to disregard the economics of the transaction and apply the component parts test to each subcomponent, Taxpayer's position is still flawed. Only some of the subcomponents (namely, SubComponent2) of ComponentX involve minimal installation activities. Even then, SubComponent2 can be installed only after Subcomponent1 have been installed. The other subcomponents are not installed in the same manner as SubComponent2. The installation of the other subcomponents involves a variety of attachment procedures and connecting devices (and in the case of SubComponent1, involves attachment to the Final ProductX, to Part1, and to SubComponent2). Moreover, SubComponent9 are usually or always installed into SubComponent2 during or after installation of the rest of ComponentX in the Final ProductX.[9]

B. Step Two

The Second Circuit's GE opinion states that, for purposes of the component parts test, a component is not subject to assembly or other processing if it remains separate and distinct from the product into which it is installed. Specifically, the component must remain separate and distinct physically (for example, routine removal and replacement), legally (for example, under FAA regulations and Government determinations), and contractually (for example, separate marketing and negotiations between the component-maker and the end-user of the final product). As explained in the GE AOD, although the Service will no longer challenge the position that aircraft engines may constitute export property under section 927(a)(1)(B) in circumstances similar to the GE fact pattern, the Service will continue to maintain that the component parts test denies export property status to a product that is incorporated into another product after sale but before delivery outside the United States with respect to aircraft engines and other products in circumstances different from the GE fact pattern. AOD 2003-04.

The GE factors do not justify a determination that ComponentX is not subject to assembly under the component parts test. First, ComponentX does not remain physically separate from Final ProductX into which it is installed. The facts do not support a conclusion that the ComponentX subcomponents are routinely removed and replaced in other Final ProductX. In fact, the installation of SubComponent1 in Final ProductX is what makes the installation of SubComponent2 possible. In other words, the process of assembling SubComponent1 and SubComponent2 is an integral step of the process of assembling ComponentX in Final ProductX. Unlike the GE engines, which were fully assembled by GE before shipment to the airframe-maker, each

[9] We also note Taxpayer's assertion during the adverse conference that the "subject to assembly" language in the component parts test refers only to assembly of the component part itself and not to assembly of the component part into a larger product. Taxpayer argues that, because ComponentX and its subcomponents were fully assembled before installation in Final ProductX, they could not have been "subject to assembly." First, we note that ComponentX was not fully assembled before installation in Final ProductX. Second, GE accepted the Government's position that "subject to assembly" includes assembly of fully assembled component parts into a finished product. 245 F.3d 149, 157. Therefore, we do not address this argument further.

ComponentX was shipped in Amount1 separate subcomponent pieces and then assembled into Final ProductX.

Like many (perhaps all) other Final ProductX components, ComponentX is interchangeable and, therefore, is designed to be easily removed when necessary but, as an integrated system (and even at the subcomponent level), is not routinely removed and replaced. In GE, the engines were routinely removed and replaced in accordance with a strict maintenance schedule. T.C.Memo. 1995-306. In contrast, Taxpayer has provided no evidence, other than vague statements and assertions, that any of the subcomponents are subject to scheduled maintenance or other routine activities that require removal and replacement of ComponentX on a predictable basis. Taxpayer's affidavit regarding removal of subcomponents that fail is unpersuasive because it merely confirms that ComponentX, like most or all Final ProductX components, can be removed if it fails.

Second, ComponentX is not legally separate and distinct from Final ProductX. The regulations generally do not apply to the individual components that comprise Final ProductX. The regulations generally distinguish between

. Although Taxpayer cited the regulations, Taxpayer was unable to identify any provisions that support its claim that ComponentX or any of its subcomponents are treated specially under those regulations in a manner similar to the special treatment of GE's engines under the FAA regulations. As we understand them, the regulations require

. The regulations do not support Taxpayer's claim that ComponentX is legally separate and distinct from Final ProductX into which it is incorporated.[10]

Taxpayer also claims that the IndustryQ regards ComponentX as separate from SuperComponentX[11] and points to the definition of SuperComponentX adopted by Industry AssociationA of which Taxpayer is a member. Furthermore, Taxpayer argues that, because ComponentX is separate from the SuperComponentX, it must also be separate from Final ProductX. Industry AssociationA defines SuperComponentX as

[10] Taxpayer also asserted that some Service publications support its claim that ComponentX is legally separate and distinct. See, e.g.,
. We view those documents as inapposite and irrelevant because they addressed and issues roughly 30 years ago, not the component parts test as illuminated by GE. In addition, in the case of the ruling, it would have no precedential value even if it were relevant.

[11] SuperComponentX is a component of Final ProductX that includes ComponentX as one of its subcomponents.

See

(emphasis added). In other words, Industry AssociationA defines SuperComponentX as the

of Final ProductX. Industry AssociationA defines equipment as "

."

The Industry AssociationA definition of SuperComponentX is inconsistent with both the definition and the standard dictionary definition. The regulations define SuperComponentX as the

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(emphasis added). In addition, the dictionary definition of Webster's II New Riverside Dictionary (1984). A

Thus, the dictionary definition, consistent with the

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Significantly, the definition of SuperComponentX specifically includes , and the Industry AssociationA defines . In short, we reject Taxpayer's assertion (based, in part, on an artificially narrow definition of SuperComponentX) that ComponentX are legally separate and distinct from the Final ProductX into which they are incorporated.

Third, ComponentX is not contractually separate and distinct. Unlike the components in GE, ComponentX was not the subject of separate marketing, solicitation, and negotiations between Taxpayer and the end-user. Nonetheless, Taxpayer argues that it warranted and marketed ComponentX to end-users not to Customer, and that this proves Taxpayer contracted directly with end-users similar to the GE factor.

Taxpayer's assertion regarding the warranty is incorrect. The Purchase Agreement indicates that the warranty is between Taxpayer and Customer unless and

until Customer at its option allows the end-user to obtain warranty benefits. Therefore, although Taxpayer's warranty eventually may pass from Customer to the end-users as a matter of practice, it does so only at Customer's option.

Nor is Taxpayer's marketing analogous to the activities described in GE. Taxpayer provided no evidence that it engages in negotiation, solicitation, or marketing activities directly with the end-user. On the contrary, all such activities occur strictly between Taxpayer and Customer. At best, Taxpayer claimed that it indirectly markets to end-users by attempting to encourage end-users to encourage Taxpayer's customers to use Taxpayer's products. Even if we were to accept this assertion, Taxpayer provided no evidence that its indirect marketing efforts had an effect on the sales at issue. The facts regarding Taxpayer's alleged indirect marketing activities are markedly different from the GE case, which involved marketing (followed by solicitation and contract negotiation) directly to the airline/end-user.

We note that our analysis of Taxpayer's claims regarding its marketing and warranty activities should not be construed as implying that our conclusion would be different if Taxpayer had, in fact, performed the sort of indirect marketing described above or had, in fact, negotiated warranty terms directly with the end-users.

C. Taxpayer's Related and Subsidiary Services Argument

Taxpayer further argues that the concept of "related and subsidiary services" in Temp. Treas. Reg. § 1.924(a)-1T(d) is meaningless if installation activities like those in this case are considered prohibited assembly under the component parts test. Temp. Treas. Reg. § 1.924(a)-1T(d)(3) defines "related services" as certain services (including installation services) performed by the taxpayer with respect to export property that the taxpayer sells or leases. Such services may be performed either within or outside the United States. Temp. Treas. Reg. § 1.924(a)-1T(d)(1). Taxpayer claims that denial of export property status under the component parts test on account of prohibited assembly activities would mean that installation services performed within the United States could never qualify as related and subsidiary services.

Taxpayer's related and subsidiary services argument is not persuasive. First, as a threshold matter, related and subsidiary services may be present only if property satisfies the component parts test as explained below. A taxpayer is treated as performing a related and subsidiary service only if a number of prerequisites, including a sale or lease of export property by the taxpayer, are satisfied. A taxpayer must have export property to have a sale or lease of export property. To have export property, a taxpayer must have property that passes the tests described in section 927 and the regulations thereunder, including the component parts test. The component parts test denies export property status to property that is subject to assembly after sale but prior to delivery outside the United States. Therefore, if prohibited assembly occurs, the question of whether related and subsidiary services are present is moot.

Second, our interpretation of the component parts test in this case does not mean that domestic installation services cannot constitute related and subsidiary services. Consider a taxpayer that sells defective export property (a subcomponent) and later, pursuant to the sale agreement and warranty, replaces the defective subcomponent and installs a new subcomponent at its facility in the United States. The sale involved export property, and the installation service performed within the United States constitutes a related service under Temp. Treas. Reg. § 1.924(a)-1T(d)(3). Taxpayer incorrectly claims that the Service's position makes it impossible for domestic installation to qualify as a related and subsidiary service.[12]

In connection with its related and subsidiary services argument, Taxpayer relies on a 1992 written determination, 1992 FSA LEXIS 256 (December 23, 1992) ("the FSA") and Treas. Reg. § 1.954-3(a)(4) as support for its position that the sort of installation activities at issue here do not constitute assembly within the meaning of the component parts test. The FSA applies the component parts test to a heavily redacted fact pattern and discusses the definition of manufacturing under the DISC, FSC, and subpart F regulations. Taxpayer focuses in particular on two points. First, the FSA states that

> [t]he regulations on this point are less expansive as [sic] they appear because assembly that does not constitute manufacturing is not prohibited. See S. Rept. No. 92-437, 1972-1 C.B. 559, 615.

In other words, Taxpayer evidently equates the term "assembly" in the component parts test with "manufacture." Second, Taxpayer focuses on the discussion of the definition of "manufacture" in Treas. Reg. § 1.954-3(a)(4). Taxpayer asserts that Treas. Reg. § 1.954-3(a)(4) "generally requires substantial transformation of property to be considered manufacturing." See Taxpayer's Legal Memorandum for the Internal Revenue Service, p.9. Taxpayer then concludes that the installation activities in the present case do not constitute manufacturing under Treas. Reg. § 1.954-3(a)(4) and, therefore, do not constitute assembly for purposes of the component parts test. Id.

We reject Taxpayer's manufacture argument for several reasons. First, the FSA is not precedential and, as such, does not represent the Service's official position regarding the component parts test. See I.R.C. § 6110(k)(3). Second, Taxpayer is incorrect that the component parts test is concerned with assembly only if such

[12] We note that, even if Taxpayer were correct regarding installation services, that would not support a different conclusion regarding the component parts test. We also note that neither installation services nor any other potential related and subsidiary services are at issue in this case. To our knowledge, Taxpayer performed no installation services with respect to ComponentX. The issue raised by Taxpayer is entirely hypothetical.

assembly amounts to manufacture. The component parts test lists four separate and distinct activities that can violate the destination test – use, manufacture, assembly, and other processing. Nothing in the language of the component parts test suggests that assembly is disregarded if it does not also constitute manufacture. Third, the relationship between manufacture and assembly, as described alternatively in the definitions of manufacture in Temp. Treas. Reg. §§ 1.993-3(c)(2) and 1.927(a)-1T(c)(2),[13] does not obligate us to reach the conclusion in the component parts test context (where manufacture and assembly are listed separately) that assembly is relevant only if it amounts to manufacture.

Fourth, the definition of manufacture under Treas. Reg. § 1.954-3(a)(4) is not relevant to the definition of assembly under Temp. Treas. Reg. § 1.927(a)-1T(d)(2)(iii). Treas. Reg. § 1.954-3(a)(4) is helpful in determining whether manufacture has occurred; it is not helpful in determining whether assembly has occurred. The issue here is the definition of "assembly," not "manufacture." Fifth, Taxpayer mischaracterizes Treas. Reg. § 1.954-3(a)(4) as a definition that "generally requires substantial transformation of property to be considered manufacturing." See Taxpayer's Legal Memorandum for the Internal Revenue Service, p. 9. In fact, Treas. Reg. § 1.954-3(a)(4) contains three alternate tests for determining whether property has been manufactured for subpart F purposes. Only one of those tests requires substantial transformation. None of the tests defines assembly.

In short, we see no support for Taxpayer's position that the separate references to manufacture and assembly in the component parts test should be read to mean "manufacture (plus assembly that constitutes manufacture)." Moreover, Treas. Reg. § 1.954-3(a)(4) is inapplicable as a technical matter (it applies for the purpose of defining manufacture, not assembly), as a practical matter (it does not define assembly), and as a matter of logic (the component parts test views manufacture and assembly separately).

In summary, the activities performed to install ComponentX in Final ProductX constitute assembly within the meaning of the component parts test in Temp. Treas. Reg. § 1.927(a)-1T(d)(2)(iii). Moreover, the Second Circuit's holding in GE – regarding component parts that retain their status as articles separate and distinct from the product into which they are installed – does not apply to ComponentX. Therefore, ComponentX does not qualify as export property that generates FSC benefits.

CAVEAT(S):

A copy of this technical advice memorandum is to be given to the taxpayer(s). Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

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[13] Temp. Treas. Reg. § 1.927(a)-1T(c)(2) incorporates a modified version of the rules in Treas. Reg. § 1.954-3(a)(4), which defines "manufacture" and refers to "assembly."