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respect to the taxable year of the DISC which includes such month or

(ii) At the close of such taxable year the sum of the DISC's money, bank deposits, and other similar temporary investments is determined under paragraph (e) of this section not to exceed an amount reasonably necessary to meet the DISC's requirements for working capital.

(Secs. 995(e)(7), (8) and (10), 995(g) and 7805 of the Internal Revenue Code of 1954 (90 Stat. 1655, 26 U.S.C. 995 (e)(7), (8) and (10); 90 Stat. 1659, 26 U.S.C. 995(g); and 68A Stat 917, 26 U.S.C. 7805))

[T.D. 7514, 42 FR 55459, Oct. 17, 1977; 42 FR 60910, Nov. 30, 1977, as amended by T.D. 7854, 47 FR 51740, Nov. 17, 1982; T.D. 7984, 49 FR 40018, Oct. 12, 1984]

§ 1.993–3 Definition of export property.

(a) *General rule.* Under section 993(c), except as otherwise provided with respect to excluded property in paragraph (f) of this section and with respect to certain short supply property in paragraph (i) of this section, export property is property in the hands of any person (whether or not a DISC)—

(1) Manufactured, produced, grown, or extracted in the United States by any person or persons other than a DISC (see paragraph (c) of this section),

(2) Held primarily for sale or lease in the ordinary course of a trade or business to any person for direct use, consumption, or disposition outside the United States (see paragraph (d) of this section),

(3) Not more than 50 percent of the fair market value of which is attributable to articles imported into the United States (see paragraph (e) of this section), and

(4) Which is not sold or leased by a DISC, or with a DISC as commission agent, to another DISC which is a member of the same controlled group (as defined in §1.993–1(k)) as the DISC.

(b) *Services.* For purposes of this section, services (including the written communication of services in any form) are not export property. Whether an item is property or services shall be determined on the basis of the facts and circumstances attending the development and disposition of the item. Thus, for example, the preparation of a map of a particular construction site would constitute services and not export property, but standard maps prepared for sale to customers generally would not constitute services and would be export property if the requirements of this section were otherwise met.

(c) *Manufacture, production, growth, or extraction of property*—(1) *By a person other than a DISC.* Export property may be manufactured, produced, grown, or extracted in the United States by any person, provided that such person does not qualify (and is not treated) as a DISC. Property held by a DISC which was manufactured, produced, grown, or extracted by it at a time when it did not qualify (and was not treated) as a DISC is not export property of the DISC. Property which sustains further manufacture or production outside the United States prior to sale or lease by a person but after manufacture or production in the United States will not be considered as manufactured, produced, grown, or extracted in the United States by such person.

(2) *Manufactured or produced*—(i) *In general.* For purposes of this section, property which is sold or leased by a person is considered to be manufactured or produced by such person if such property is manufactured or produced (within the meaning of either subdivision (ii), (iii), or (iv) of this subparagraph) by such person or by another person pursuant to a contract with such person. Except as provided in subdivision (iv) of this subparagraph, manufacture or production of property does not include assembly or packaging operations with respect to property.

(ii) *Substantial transformation.* Property is manufactured or produced by a person if such property is substantially transformed by such person. Examples of substantial transformation of property would include the conversion of woodpulp to paper, steel rods to screws and bolts, and the canning of fish.

(iii) *Operations generally considered to constitute manufacturing.* Property is manufactured or produced by a person if the operations performed by such person in connection with such property are substantial in nature and are generally considered to constitute the manufacture or production of property.

(iv) *Value added to property.* Property is manufactured or produced by a person if with respect to such property conversion costs (direct labor and factory burden including packaging or assembly) of such person account for 20 percent of more of—

(*a*) The cost of goods sold or inventory amount of such person for such property is such property is sold or held for sale, or

(*b*) The adjusted basis of such person for such property, as determined in accordance with the provisions of section 1011, if such property is held for lease or leased.

The value of parts provided pursuant to a services contract, as described in §1.993–1 (d)(4)(v), is not taken into account in applying this subdivision.

(d) *Primary purpose of which property is held*—(1) *In general*—(i) *General rule.* Under paragraph (a)(2) of this section, export property (*a*) must be held primarily for the purpose of sale or lease in the ordinary course of trade or business to a DISC, or to any other person, and (*b*) such sale or lease must be for direct use, consumption, or disposition outside the United States. Thus, property cannot qualify as export property unless it is sold or leased for direct use, consumption or disposition outside the United States. Property is sold or leased for direct use, consumption, or disposition outside the United States if such sale or lease satisfies the destination test described in subparagraph (2) of this paragraph, the proof of compliance requirements described in subparagraph (3) of this paragraph, and the use outside the United States test described in subparagraph (4) of this paragraph.

(ii) *Factors not taken into account.* In determining whether property which is sold or leased to a DISC is sold or leased for direct use consumption, or disposition outside the United States, the fact that the acquiring DISC holds the property in inventory or for lease prior to the time it sells or leases it for direct use, consumption, or disposition outside the United States will not affect the characterization of the property as export property. Export property need not be physically segregated from other property.

(2) *Destination test.* (i) For purposes of subparagraph (1) of this paragraph the destination test in this subparagraph is satisfied with respect to property sold or leased by a seller or lessor only if it is delivered by such seller or lessor (or an agent of such seller or lessor) regardless of the F.O.B. point or the place at which title passes or risk of loss shifts from the seller or lessor—

(*a*) Within the United States to a carrier or freight forwarder for ultimate delivery outside the United States to a purchaser or lessee (or to a subsequent purchaser or sublessee),

(*b*) Within the United States to a purchaser or lessee, if such property is ultimately delivered, directly used, or directly consumed outside the United States (including delivery to a carrier or freight forwarder for delivery outside the United States) by the purchaser or lessee (or a subsequent purchaser or sublessee) within 1 year after such sale or lease,

(*c*) Within or outside the United States to a purchaser or lessee which, at the time of the sale or lease, is a DISC and is not a member of the same controlled group (as defined in §1.993–1(k)) as the seller or lessor,

(*d*) From the United States to the purchaser or lessee (or a subsequent purchaser or sublessee) at a point outside the United States by means of a ship, aircraft, or other delivery vehicle, owned, leased, or chartered by the seller or lessor,

(*e*) Outside the United States to a purchaser or lessee from a warehouse, a storage facility, or assembly site located outside the United States, if such property was previously shipped by such seller or lessor from the United States, or

(*f*) Outside the United States to a purchaser or lessee if such property was previously shipped by such seller or lessor from the United States and if such property is located outside the United States pursuant to a prior lease by the seller or lessor, and either (*1*) such prior lease terminated at the expiration of its term (or by the action of the prior lessee acting alone), (*2*) the sale occurred or the term of the subsequent lease began after the time at which the term of the prior lease would have expired, or (*3*) the lessee under the

subsequent lease is not a related person (as defined in §1.993–1(a)(6)) with respect to the lessor and the prior lease was terminated by the action of the lessor (acting alone or together with the lessee).

(ii) For purposes of this subparagraph (other than (*c*) and (*f*)(*3*) of subdivision (i) thereof), any relationship between the seller or lessor and any purchaser, subsequent purchaser, lessee, or sublessee is immaterial.

(iii) In no event is the destination test of this subparagraph 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 or lessor and the delivery or ultimate delivery outside the United States described in this subparagraph.

(iv) If property is located outside the United States at the time it is purchased by a person or leased by a person as lessee, such property may be export property in the hands of such purchaser or lessee only if it is imported into the United States prior to its further sale or lease (including a sublease) outside the United States. Paragraphs (a)(3) and (e) of this section (relating to 50 percent foreign content test) are applicable in determining whether such property is export property. Thus, for example, if such property is not subjected to manufacturing or production (as defined in paragraph (c) of this section) within the United States after such importation, it does not qualify as export property.

(3) *Proof of compliance with destination test*—(i) *Delivery outside the United States.* For purposes of subparagraph (2) of this paragraph (other than subdivision (i)(*c*) thereof), a seller or lessor shall establish ultimate delivery, use, or consumption of property outside the United States by providing—

(*a*) A facsimile or carbon copy of the export bill of lading issued by the carrier who delivers the property,

(*b*) A certificate of an agent or representative of the carrier disclosing delivery of the property outside the United States,

(*c*) A facsimile or carbon copy of the certificate of lading for the property executed by a customs officer of the country to which the property is delivered,

(*d*) If such country has no customs administration, a written statement by the person to whom delivery outside the United States was made,

(*e*) A facsimile or carbon copy of the shipper's export declaration, a monthly shipper's summary declaration filed with the Bureau of Customs, or a magnetic tape filed in lieu of the Shipper's Export Declaration, covering the property,

(*f*) Any other proof (including evidence as to the nature of the property or the nature of the transaction) which establishes to the satisfaction of the Commissioner that the property was ultimately delivered, or directly sold, or directly consumed outside the United States within 1 year after the sale or lease.

(ii) The requirements of subdivision (i) (*a*), (*b*), (*c*), or (*e*) of this subparagraph will be considered satisfied even though the name of the ultimate consignee and the price paid for the goods is marked out provided that, in the case of a Shipper's Export Declaration or other document listed in such subdivision (*e*) or a document such as an export bill of lading such document still indicates the country in which delivery to the ultimate consignee is to be made and, in the case of a certificate of an agent or representative of the carrier, that such document indicates that the property was delivered outside the United States.

(iii) A seller or lessor shall also establish the meeting of the requirement of subparagraph (2)(i) of this paragraph (other than subdivision (*c*) thereof), that the property was delivered outside the United States without further use, manufacture, assembly, or other processing within the United States.

(iv) *Sale or lease to an unrelated DISC.* For purposes of subparagraph (2)(i)(*c*) of this paragraph, a purchaser or lessee of property is deemed to qualify as a DISC for its taxable year if the seller or lessor obtains from such purchaser or lessee a copy of such purchaser's or lessee's election to be treated as a DISC as described in §1.992–2(a) together with such purchaser's or lessee's sworn statement that such election has

been filed with the Internal Revenue Service Center. The copy of the election and the sworn statement of such purchaser or lessee must be received by the seller or lessor within 6 months after the sale or lease. A purchaser or lessee is not treated as a DISC with respect to a sale or lease during a taxable year for which such purchaser or lessee does not qualify as a DISC if the seller or lessor does not believe or if a reasonable person would not believe at the time such sale or lease is made that the purchaser or lessee will qualify as a DISC for such taxable year.

(v) *Failure of proof.* If a seller or lessor fails to provide proof of compliance with the destination test as required by this subparagraph, the property sold or leased is not export property.

(4) *Sales and leases of property for ultimate use in the United States*—(i) *In general.* For purposes of subparagraph (1) of this paragraph, the use test in this subparagraph is satisfied with respect to property which—

(*a*) Under subdivisions (ii) through (iv) of this subparagraph is not sold for ultimate use in the United States or

(*b*) Under subdivision (v) of this subparagraph is leased for ultimate use outside the United States.

(ii) *Sales of property for ultimate use in the United States.* For purposes of subdivision (i) of this subparagraph, a purchaser of property (including components, as defined in subdivision (vii) of this subparagraph) is deemed to use such property ultimately in the United States if any of the following conditions exists:

(*a*) Such purchaser is a related person (as defined in §1.993–1(a)(6)) with respect to the seller and such purchaser ultimately uses such property, or a second product into which such property is incorporated as a component, in the United States.

(*b*) At the time of the sale, there is an agreement or understanding that such property, or a second product into which such property is incorporated as a component, will be ultimately used by the purchaser in the United States.

(*c*) At the time of the sale, a reasonable person would have believed that such property or such second product would be ultimately used by such purchaser in the United States unless, in the case of a sale of components, the fair market value of such components at the time of delivery to the purchaser constitutes less than 20 percent of the fair market value of the second product into which such components are incorporated (determined at the time of completion of the production, manufacture or assembly of such second product).

For purposes of (b) of this subdivision, there is an agreement or understanding that property will ultimately be used in the United States if, for example, a component is sold abroad under an express agreement with the foreign purchaser that the component is to be incorporated into a product to be sold back to the United States. As a further example there would also be such an agreement or understanding if the foreign purchaser indicated at the time of the sale or previously that the component is to be incorporated into a product which is designed principally for the United States market. However, such an agreement or understanding does not result from the mere fact that a second product, into which components exported from the United States have been incorporated and which is sold on the world market, is sold in substantial quantities in the United States.

(iii) *Use in the United States.* For purposes of subdivision (ii) of this subparagraph, property (including components incorporated into a second product) is or would be ultimately used in the United States by such purchaser if, at any time within 3 years after the purchase of such property or components, either such property or components (or the second product into which such components are incorporated) is resold by such purchaser for use by a subsequent purchaser within the United States or such purchaser or subsequent purchaser fails, for any period of 365 consecutive days, to use such property or second product predominantly outside the United States as defined in subdivision (vi) of this subparagraph).

(iv) *Sales to retailers.* For purposes of subdivision (ii)(*c*) of this subparagraph, property sold to any person whose principal business consists of selling from inventory to retail customers at retail outlets ouside the United States will be

considered as property for ultimate use outside the United States.

(v) *Leases of property for ultimate use outside the United States.* For purposes of subdivision (i) of this subparagraph a lessee of property is deemed to use such property ultimately outside the United States during a taxable year of the lessor if such property is used predominantly outside the United States (as defined in subdivision (vi) of this subparagraph) by the lessee during the portion of the lessor's taxable year which is included within the term of the lease. A determination as to whether the ultimate use of leased property satisfies the requirements of this subdivision is made for each taxable year of the lessor. Thus, leased property may be used predominantly outside the United States for a taxable year of the lessor (and thus, constitute export property if the remaining requirements of this section are met) even if the property is not used predominantly outside the United States in earlier taxable years or later taxable years of the lessor.

(vi) *Predominant use outside the United States.* For purposes of this subparagraph, property is used predominantly outside the United States for any period if, during such period, such property is located outside the United States more than 50 percent of the time. An aircraft, railroad rolling stock, vessel, motor vehicle, container, or other property used for transportation purposes in deemed to be used predominantly outside the United States for any period if, during such period, either such property is located outside the United States more than 50 percent of the time or more than 50 percent of the miles traversed in the use of such property are traversed in outside the United States. However, any such property is deemed to be within the United States at all times during which it is engaged in transport between any two points within the United States, except where such transport constitutes uninterrupted international air transportation within the meaning of section 4262(c)(3) and the regulations thereunder (relating to tax on air transportation of persons). For purposes of applying section 4262(c)(3) to this subdivision, the term ''United States'' has the same meaning as in §1.993–7.

(vii) *Component.* For purposes of this subparagraph, a component is property which is (or is reasonably expected to be) incorporated into a second product by the purchaser of such component by means of production, manufacture, or assembly.

(e) *Foreign content of property*—(1) *The 50 percent test.* Under paragraph (a)(3) of this section, no more than 50 percent of the fair market value of export property may be attributable to the fair market value of articles which were imported into the United States. For purposes of this paragraph, articles imported into the United States are referred to as ''foreign content''. The fair market value of the foreign content of export property is computed in accordance with subparagraph (4) of this paragraph. The fair market value of export property which is sold to a person who is not a related person with respect to the seller is the sale price for such property (not including interest finance or carrying charges, or similar charges)

(2) *Application of 50 percent test.* The 50 percent test described in subparagraph (1) of this paragraph is applied on an item-by-item basis If, however, a person sells or leases a substantial volume of substantially identical export property in a taxable year and if all of such property contains substantially identical foreign content is substantially the same proportion, such person may determine the portion of foreign content contained in such property on an aggregate basis.

(3) *Parts and services.* If, at the time property is sold or leased the seller or lessor agrees to furnish parts pursuant to a services contract (as provided in §1.993–1(d)(4)(v)) and the price for the parts is not separately stated, the 50 percent test described in subparagraph (1) of this paragraph is applied on an aggregate basis to the property and parts. If the price for the parts is described in subparagraph (1) of this paragraph is applied separately to the property and to the parts.

(4) *Computation of foreign content*—(i) *Valuation.* For purposes of applying the

50 percent test described in subparagraph (1) of this paragraph, it is necessary to determine the fair market value of all articles which constitute foreign content of the property being tested to determine if it is export property. The fair market value of such imported articles is determined as of the time such articles are imported into the United States. With respect to articles imported into the United States before July 1, 1980, the fair market value of such articles is their appraised value as determined under section 402 or 402a of the Tariff Act of 1930 (19 U.S.C. 1401a or 1402) in connection with their importation. With respect to articles imported into the United States on or after July 1, 1980, the fair market value of such articles is their appraised value as determined under section 402 of the Tariff Act of 1930 (19 U.S.C. 1401a) in connection with their importation. The appraised value of such articles is the full dutiable value of such articles, determined, however, without regard to any special provision in the United States tariff laws which would result in a lower dutiable value. Thus, an article which is imported into the United States is treated as entirely imported even if all or a portion of such article was originally manufactured, produced, grown, or extracted in the United States.

(ii) *Evidence of fair market value.* For purposes of subdivision (i) of this subparagraph, the fair market value of imported articles constituting foreign content may be evidenced by the customs invoice issued on the importation of such articles into the United States. If the holder of such articles is not the importer (or a related person with respect to the importer), the fair market value of such articles may be evidenced by a certificate based upon information contained in the customs invoice and furnished to the holder by the person from whom such articles (or property incorporating such articles) were purchased. If a customs invoice or certificate described in the preceding sentence is not available to a person purchasing property, such person shall establish that no more than 50 percent of the fair market value of such property is attributable to the fair market value of articles which were imported into the United States.

(iii) *Interchangeable component articles*—(*a*) Where identical or similar component articles can be incorporated interchangeably into property and a person acquires some such component articles that are imported into the United States and other such component articles that are not imported into the United States, the determination whether imported component articles were incorporated in such property as is exported from the United States shall be made on a substitution basis as in the case of the rules relating to drawback accounts under the customs laws. See section 313(b) of the Tariff Act of 1930, as amended (19 U.S.C. 1313(b)).

(*b*) The provisions of (*a*) of this subdivision may be illustrated by the following example:

Example. Assume that a manufacturer produces a total of 20,000 electronic devices. The manufacturer exports 5,000 of the devices and subsequently sells 11,000 of the devices to a DISC which exports the 11,000 devices. The major single component article in each device is a tube which represents 60 percent of the fair market value of the device at the time the device is sold by the manufacturer. The manufacturer imports 8,000 of the tubes and produces the remaining 12,000 tubes. For purposes of this subdivision, in accordance with the substitution principle used in the customs drawback laws, the 5,000 devices exported by the manufacturer are each treated as containing an imported tube because the devices were exported prior to the sale to the DISC. The remaining 3,000 imported tubes are treated as being contained in the first 3,000 devices purchased and exported by the DISC. Thus, since the 50 percent test is not met with respect to the first 3,000 devices purchased and exported by the DISC, those devices are not export property. The remaining 8,000 devices purchased and exported by the DISC are treated as containing tubes produced in United States, and those devices are export property (if they otherwise meet the requirements of this section).

(f) *Excluded property*—(1) *In general.* Notwithstanding any other provision of this section, the following property is not export property—

(i) Property described in subparagraph (2) of this paragraph (relating to property leased to a member of a controlled group),

(ii) Property described in subparagraph (3) of this paragraph (relating to certain types of intangible property),

(iii) Products described in paragraph (g) of this section (relating to depletable products), and

(iv) Products described in paragraph (h) of this section (relating to certain export controlled products).

(2) *Property leased to member of controlled group*—(i) *In general.* Property leased to a person (whether or not a DISC) which is a member of the same controlled group (as defined in §1.993–1(k)) as the lessor constitutes export property for any period of time only if during the period—

(*a*) Such property is held for sublease, or is subleased, by such person to a third person for the ultimate use of such third person;

(*b*) Such third person is not a member of the same controlled group; and

(*c*) Such property is used predominantly outside the United States by such third person.

(ii) *Predominant use.* The provisions of paragraph (d)(4)(vi) of this section apply in determining under subdivision (i)(*c*) of this subparagraph whether such property is used predominently outside the United States by such third person.

(iii) *Leasing rule.* For purposes of this subparagraph, leased property is deemed to be ultimately used by a member of the same controlled group as the lessor if such property is leased to a person which is not a member of such controlled group but which subleases such property to a person which is a member of such controlled group. Thus, for example, if X, a DISC for the taxable year, leases a movie film to Y, a foreign corporation which is not a member of the same controlled group as X, and Y then subleases the film to persons which are members of such group for showing to the general public, the film is not export property. On the other hand, if X, a DISC for the taxable year, leases a movie film to Z, a foreign corporation which is a member of the same controlled group as X, and Z then subleases the film to Y, another foreign corporation, which is not a member of the same controlled group for showing to the general public, the film is not disqualified under this subparagraph from being export property.

(iv) *Certain copyrights.* With respect to a copyright which is not excluded by subparagraph (3) of this paragraph from being export property, the ultimate use of such property is the sale or exhibition of such property to the general public. Thus, if A, a DISC for the taxable year, leases recording tapes to B, a foreign corporation which is a member of the same controlled group as A, and if B makes records from the recording tape and sells the records to C, another foreign corporation, which is not a member of the same controlled group, for sale by C to the general public, the recording tape is not disqualified under this subparagraph from being export property, notwithstanding the leasing of the recording tape by A to a member of the same controlled group, since the ultimate use of the tape is the sale of the records (*i.e.*, property produced from the recording tape).

(3) *Intangible property.* Export property does not include any patent, invention, model, design, formula, or process, whether or not patented, or any copyright (other than films, tapes, records, or similar reproductions, for commercial or home use), goodwill, trademark, tradebrand, franchise, or other like property. Although a copyright such as a copyright on a book does not constitute export property, a copyrighted article (such as a book) if not accompanied by a right to reproduce it is export property if the requirements of this section are otherwise satisfied. However, a license of a master recording tape for reproduction outside the United States is not disqualified under this subparagraph from being export property.

(g) *Depletable products*—(1) *In general.* Under section 993(c)(2)(C), a product or commodity which is a depletable product (as defined in subparagraph (2) of this paragraph) or contains a depletable product is not export property if—

(i) It is a primary product from oil, gas, coal, or uranium (as described in subparagraph (3) of this paragraph), or

(ii) It does not qualify as a 50-percent manufactured or processed product (as described in subparagraph (4) of this paragraph).

(2) *Definition of ''depletable product''.* For purposes of this paragraph, the term ''depletable product'' means any product or commodity of a character with respect to which a deduction for depletion is allowable under section 613 or 613A. Thus, the term depletable product includes any mineral extracted from a mine, an oil or gas well, or any other natural deposit, whether or not the DISC or related supplier is allowed a deduction, or is eligible to take a deduction, for depletion with respect to the mineral in computing its taxable income. Thus, for example, iron ore purchased by a DISC from a broker is a depletable product in the hands of the DISC for purposes of this paragraph even though the DISC is not eligible to take a deduction for depletion under section 613 or 613A.

(3) *Primary product from oil, gas, coal, or uranium.* A primary product from oil, gas, coal, or uranium is not export property. For purposes of this paragraph—

(i) *Primary product from oil.* The term ''primary product from oil'' means crude oil and all products derived from the destructive distillation of crude oil, including—

(*a*) Volatile products,

(*b*) Light oils such as motor fuel and kerosene,

(*c*) Distillates such as naphtha,

(*d*) Lubricating oils,

(*e*) Greases and waxes, and

(*f*) Residues such as fuel oil.

For purposes of this paragraph, a product or commodity derived from shale oil which would be a primary product from oil if derived from crude oil is considered a primary product from oil.

(ii) *Primary product from gas.* The term ''primary product from gas'' means all gas and associated hydrocarbon components from gas wells or oil wells, whether recovered at the lease or upon further processing, including—

(*a*) Natural gas,

(*b*) Condensates,

(*c*) Liquefied petroleum gases such as ethane, propane, and butane, and

(*d*) Liquid products such as natural gasoline.

(iii) *Primary product from coal.* The term ''primary product from coal'' means coal and all products recovered from the carbonization of coal including—

(*a*) Coke,

(*b*) Coke-oven gas,

(*c*) Gas liquor,

(*d*) Crude light oil, and

(*e*) Coal tar.

(iv) *Primary product from uranium.* The term ''primary product from uranium'' means uranium ore and uranium concentrates (known in the industry as ''yellow cake''), and nuclear fuel materials derived from the refining of uranium ore and uranium concentrates, or produced in a nuclear reaction, including—

(*a*) Uranium hexafluoride,

(*b*) Enriched uranium hexafluoride,

(*c*) Uranium metal,

(*d*) Uranium compounds, such as uranium carbide,

(*e*) Uranium dioxide, and

(*f*) Plutonium fuels.

(v) *Primary products and changing technology.* The primary products from oil, gas, coal, or uranium described in subdivisions (i) through (iv) of this subparagraph and the processes described in those subdivisions are not intended to represent either the only primary products from oil, gas, coal, or uranium, or the only processes from which primary products may be derived under existing and future technologies, such as the gasification and liquefaction of coal.

(vi) *Petrochemicals.* For purposes of this paragraph, petrochemicals are not considered primary products from oil, gas, or coal.

(4) *50-percent manufactured or processed product*—(i) *In general.* A product or commodity (other than a primary product from oil, gas, coal, or uranium) which is or contains a depletable product is not excluded from the term ''export property'' by reason of section 993(c)(2)(C) if it is a 50-percent manufactured or processed product. Such a product or commodity is a ''50-percent manufactured or processed product'' if, after the cutoff point of the depletable product, it is manufactured or processed (as defined in subdivision (ii) of this subparagraph) and either the cost test described in subdivision (iv) of this subparagraph or the fair market value test described in subdivision (v) of this subparagraph is satisfied. To determine

cutoff point, see subdivisions (vi) and (vii) of this subparagraph.

(ii) *Manufactured or processed.* A product is manufactured or processed if it is manufactured or produced within the meaning of paragraph (c)(2) of this section, except that for purposes of this subdivision the term manufacturing or processing does not include any excluded process (as defined in subdivision (iii) of this subparagraph) and the term conversion costs (as used in subdivision (iv) of such paragraph (c)(2)) does not include any costs attributable to any excluded process.

(iii) *Excluded processes.* For purposes of this paragraph, excluded processes are extracting (*i.e.,* all processes which are applied before the cutoff point of the mineral to which such processes are applied), and handling, packing, packaging, grading, storing, and transporting.

(iv) *Cost test.* A product or commodity will qualify as a 50-percent manufactured or processed product if—

(*a*) Its manufacturing and processing costs (that is, the portion of the cost of goods sold or inventory amount of the product or commodity attributable to the aggregate cost of manufacturing or processing each mineral contained therein) equal or exceed—

(*b*) An amount equal to either of the following:

(*1*) 50 percent of its cost of goods sold or inventory amount (decreased, at the DISC's option, by the portion of such cost or amount the DISC establishes is allocable to the difference between each prior owner's selling price for each depletable product contained in such product or commodity and such prior owner's cost of goods sold with respect thereto).

(*2*) The aggregate of the cost at the cutoff point (see subdivisions (vi) and (vii) of this subparagraph) properly attributable to each mineral contained in such product or commodity. However, if this subdivision (*2*) is applied, then the amount in (*a*) of this subparagraph (iv) shall be decreased and the amount in this subdivision (*2*) shall be increased, by so much of the cost of goods sold or inventory amount of the product or commodity as is properly allocable to any process other than transportation applied after the cutoff point of such mineral which would be a mining process (within the meaning of §1.613–4) were it applied before such point.

(v) *Fair market value test.* A product or commodity will qualify as a 50-percent manufactured or processed product if—

(*a*) The excess of its fair market value on the date it is sold, exchanged, or otherwise disposed of (or, if not sold, exchanged, or otherwise disposed of, the last day of the DISC's taxable year) over the portion thereof properly allocable to excluded processes other than extracting is equal to or greater than

(*b*) Twice the aggregate of the fair market value at the cutoff point for each mineral contained in such product or commodity.

For purposes of this subdivision (v), the fair market value of a product or commodity on the date it is sold, exchanged, or otherwise disposed of is the price at which it is disposed of, subject to any adjustment that may be required under the arm's length standard of section 482 and the regulations thereunder. If such product or commodity is not sold, exchanged, or otherwise disposed of, then, for purposes of section 992(a)(1)(B) (relating to the 95-percent test with respect to qualified export assets), the fair market value of a product or commodity on the last day of the DISC's taxable year is the arm's length price at which such product or commodity would have been sold on such date, determined by applying the principles of section 482 and the regulations thereunder.

(vi) *Cutoff point of a mineral.* For purposes of this subparagraph:

(*a*) The cutoff point is the point at which gross income from the property (within the meaning of section 613(a)) was in fact determined.

(*b*) The cost at the cutoff point is deemed to be the amount of the gross income from the property of the taxpayer eligible for a depletion deduction with respect to the mineral.

(*c*) The fair market value at the cutoff point is deemed to be the amount of the gross income from the property of the taxpayer eligible for a depletion deduction with respect to the mineral, except that, if (*1*) the fair market value of a product or commodity on the date

specified in subdivision (v)(*a*) of this subparagraph exceeds the aggregate of the fair market value at the cutoff point for each mineral contained therein and (*2*) 10 percent or more of such excess is attributable to a net increase in the fair market values of such minerals by reason of factors other than manufacturing or processing or the application of excluded processes (such as, for example, increases in the fair market values of some minerals by reason of inflation or speculation exceed decreases in such values of other minerals by reason of deflation or speculation), then the aggregate of the fair market value at the cutoff point for each such mineral shall be increased to reflect the net excess so attributable.

(*d*) The provisions of this subdivision (vi) are illustrated by the following example.

Example. An integrated manufacturer, X, on February 1, 1976, had gross income from the property (within the meaning of section 613(a)) of $50 with respect to a specified volume of a mineral. Thus, the cost at the cutoff point of the mineral was $50. X converted the mineral into a product which it sold on July 15, 1976, for $75. Of the $25 excess of the selling price over the gross income from the property, $23 was attributable to manufacturing, processing, and the application or excluded processes, and $2 was attributable to an increase in the fair market value of the mineral due to inflation between February 1 and July 15, 1976. Since only 8 percent of such excess ($2/$25) was attributable to factors other than manufacturing, processing, and the application of excluded processes, the fair market value at the cutoff point of the mineral is $50. However, had $3 of the $25 excess, or 12 percent, been attributable to an increase in the fair market value of the mineral due to inflation, then the fair market value at the cutoff point of the mineral would be $53.

(vii) [Reserved]

(viii) *Special rule for certain used products and scrap products.* If a product or commodity is a used 50-percent manufactured or processed product, or is recovered as scrap from a 50-percent manufactured or processed product, such product or commodity will be treated as a 50-percent manufactured or processed product.

(ix) *Special rule for byproducts and waste products.* For purposes of applying the cost test or fair market value test of subdivision (iv) or (v) of this subparagraph if a depletable product is recovered from a manufacturing process as a byproduct or waste product, then the cost and fair market value at the cutoff point are each deemed to be the lesser of—

(*a*) The fair market value of the waste product or byproduct containing the depletable product, determined as of the date the byproduct or waste product is recovered, or

(*b*) The amount the cost at the cutoff point would be for a depletable product of like kind and grade which is extracted, determined as of the date the byproduct or waste product is recovered.

For purposes of (*b*) of this subdivision the cutoff point for the depletable product of like kind and grade is deemed to be the point at which gross income from the property would be determined if such depletable product were sold by the taxpayer eligible to take a deduction for depletion after the completion of all mining processes applied to the depletable product and before the application of any nonmining process.

(x) *Proof of satisfaction of 50-percent manufactured or processed test.* (*a*) No substantiation is required to establish that either the cost test or the fair market value test of subdivisions (iv) or (v) of this subparagraph is satisfied or that a product or commodity qualifies under (viii) of this subdivision as either a used 50-percent manufactured or processed product or as scrap from a 50-percent manufactured or processed product as long as it is reasonably obvious, on the basis of all relevant facts and circumstances, that either the cost test or fair market value test is satisfied, or that the product or commodity qualifies as either as used 50-percent manufactured or processed product or as scrap from a 50-percent manufactured or processed product. Thus, for example, in the case of a DISC exporting a high precision lens at least 50 percent of the fair market value of which is obviously attributable to grinding, no substantiation of gross income from the property properly allocable to the depletable products contained in the lens, cost, or fair market values will be required.

(*b*) In cases in which satisfaction of either the cost test or the fair market value test is not reasonably obvious, a DISC will be required to substantiate the gross income from the property properly allocable to each depletable product in a product or commodity and either all costs or fair market values relied upon the DISC.

(*c*) For purposes of substantiating (*1*) gross income from the property properly allocable to a depletable product, (*2*) costs, and (*3*) fair market values, the DISC and related supplier shall each identify items in (or that were in) inventory in the same manner each used to identify items in inventory for purposes of computing Federal income tax.

(xi) *Application of 50-percent test.* The 50-percent test described in this subparagraph is applied on an item-by-item basis. If, however, a DISC sells a substantial volume of substantially identical products or commodities and if all or a group of such products or commodities contain substantially identical depletable products in substantially the same proportions and have cost or fair market value relationships (as the case may be) that are in substantially the same proportions, such DISC may apply the 50-percent test on an aggregate basis with respect to all such products or commodities, or group, as the case may be.

(5) *Effective dates.* Except as provided in subparagraph (6) of this paragraph, section 993(c)(2)(C) applies—

(i) With respect to any product or commodity not owned by a DISC, to sales, exchanges, or other dispositions made after March 18, 1975, with respect to which the DISC derives gross receipts.

(ii) With respect to any product or commodity acquired by a DISC after March 18, 1975.

(iii) With respect to any product or commodity owned by a DISC on March 18, 1975, to sales, exchanges, or other dispositions made after March 18, 1976, and to owning such product or commodity after such date.

For purposes of this paragraph and subparagraph (6) of this paragraph, the date of a sale, exchange, or other disposition of a product or commodity is the date as of which title to such product or commodity passes. The accounting method of a person is not determinative of the date of a sale, exchange, or other disposition.

(6) *Fixed contracts.* Section 1101(f) of the Tax Reform Act of 1976 provides an exception to the effective date rules in this paragraph and in paragraph (h) of this section. Section 1101(f)(2) of the Act provides that section 993(c)(2)(C) and (D) shall not apply to sales, exchanges, and other dispositions made after March 18, 1975, but before March 19, 1980, if they are made pursuant to a fixed contract. Section 1101(f)(2) also defines fixed contract. Under that definition, if the seller can vary the price of the product for unspecified cost increases (which could include tax cost increases), or if the quantity of products or commodities to be sold can be increased or decreased under the contract by the seller without penalty, the contract is not to be considered a fixed contract with respect to the amount over which the seller has discretion. For example, if a contract calls for a minimum delivery of x amount of a product but allows the seller to refuse to deliver goods beyond that minimum amount (or allows a renegotiation of the sales price of goods beyond that amount), then with respect to the amount above the minimum the contract is not a fixed quantity contract.

(h) *Export controlled products*—(1) *In general.* An export controlled product is not export property. A product or commodity may be an export controlled product at one time but not an export controlled product at another time. For purposes of this paragraph, a product or commodity is an ''export controlled product'' at a particular time if at that time the export of such product or commodity is prohibited or curtailed under section 4(b) of the Export Administration Act of 1969 or section 7(a) of the Export Administration Act of 1979, to effectuate the policy relating to the protection of the domestic economy set forth in such Acts (paragraph (2)(A) of section 3 of the Export Administration Act of 1969 and paragraph (2)(C) of section 3 of the Export Administration Act of 1979). Such policy is to use export controls to the extent necessary ''to protect the domestic economy from the excessive drain of scarce

materials and to reduce the serious inflationary impact of foreign demand.''

(2) *Products considered export controlled products*—(i) *In general.* For purposes of this paragraph, an export controlled product is a product or commodity which is subject to short supply export controls under 15 CFR part 377. A product or commodity is considered an export controlled product for the duration of each control period which applies to such product or commodity. A control period of a product or commodity begins on and includes the initial control date (as defined in subdivision (ii) of this subparagraph) and ends on and includes the final control date (as defined in subdivision (iii) of this subparagraph).

(ii) *Initial control date.* The initial control date of a product or commodity which was subject to short supply export controls on March 19, 1975, is March 19, 1975. The initial control date of a product or commodity which is subject to short supply export controls after March 19, 1975, is the effective date stated in the regulations to 15 CFR part 377 which subjects such product or commodity to short supply export controls. If there is no effective date stated in such regulations, the initial control date of such product or commodity is the date on which such regulations are filed for publications in the FEDERAL REGISTER.

(iii) *Final control date.* The final control date of a product or commodity is the effective date stated in the regulations to 15 CFR part 377 which removes such product or commodity from short supply export controls. If there is no effective date stated in such regulations, the final control date of such product or commodity is the date on which such regulations are filed for publication in the FEDERAL REGISTER.

(iv) *Expiration of Export Administration Act.* An initial control date and a final control date cannot occur after the expiration date of the Export Administration Act under the authority of which the short supply export controls were issued.

(3) *Effective dates*—(i) *Products controlled on March 19, 1975.* Except as provided in paragraph (g)(6) of this section, if a product or commodity was subject to short supply export controls on March 19, 1975, this paragraph applies—

(*a*) With respect to any such product or commodity not owned by a DISC, to sales, exchanges, other dispositions, or leases made after March 18, 1975, with respect to which the DISC derives gross receipts.

(*b*) With respect to any such product or commodity acquired by a DISC after March 18, 1975, and

(*c*) With respect to any such product or commodity owned by a DISC on March 18, 1975, to sales, exchanges, other dispositions, and leases made after March 18, 1976, and to owning such product or commodity after such date.

(ii) *Products first controlled after March 19, 1975.* If a product or commodity becomes subject to short supply export controls after March 19, 1975, this paragraph applies to sales, exchanges, other dispositions, or leases of such product or commodity made on or after the initial control date of such product or commodity, and to owning such product or commodity on or after such date.

(iii) *Date of sale, exchange, lease, or other disposition.* For purposes of this subparagraph, the date of sale, exchange, or other disposition of a product or commodity is the date as of which title to such product or commodity passes. The date of a lease is the date as of which the lessee takes possession of a product or commodity. The accounting method of a person is not determinative of the date of sale, exchange, other disposition, or lease.

(iv) *Property in short supply.* If the President determines that the supply of any property which is otherwise export property as defined in this section is insufficient to meet the requirements of the domestic economy, he may by Executive order designate such property as in short supply. Any property so designated will be treated as property which is not export property during the period beginning with the date specified in such Executive order and ending with the date specified in an Executive order setting forth the

President's determination that such property is no longer in short supply.

[T.D. 7514, 42 FR 55461, Oct. 17, 1977, as amended by T.D. 7513, 42 FR 57309, Nov. 2, 1977; T.D. 7854, 47 FR 51740, Nov. 17, 1982]

§ 1.993–4 Definition of producer's loans.

(a) *General rule*—(1) *Definition.* Under section 993(d), a loan made by a DISC to a person, referred to in this section as the ''borrower,'' is a producer's loan if—

(i) The loan is made out of accumulated DISC income within the meaning of subparagraph (3) of this paragraph.

(ii) The loan is evidenced by an obligation described in subparagraph (4) of this paragraph.

(iii) The requirement as to the trade or business of the borrower described in subparagraph (5) of this paragraph is satisfied.

(iv) At the time the loan is made, the obligation referred to in subdivision (ii) of this subparagraph bears a legend stating ''This Obligation Is Designated A Producer's Loan Within The Meaning of section 993(d) of the Internal Revenue Code'' or words of substantially the same meaning.

(v) The limitation as to the export-related assets of the borrower described in paragraph (b) of this section is satisfied.

(vi) The requirement as to the increased investment of the borrower in export-related assets described in paragraph (c) of this section is satisfied, and

(vii) The requirement of paragraph (d) of this section as to proof of compliance with paragraphs (b) and (c) of this section is satisfied.

(2) *Application of this section*—(i) *In general.* A loan which is a producer's loan is a qualified export asset of the DISC (see §1.993–2(a)(5) and (F)). The interest on a producer's loan is a qualified export receipt of the DISC (see §1.993–1(g)). A producer's loan is not a dividend to a borrower which is also a shareholder of the DISC making the loan. For rules with respect to deemed distributions by reason of the amount of foreign investment attributable to producer's loans, see section 995(b)(1)(G) and (d) and the regulations thereunder.

(ii) *No tracing of loan proceeds.* For purposes of applying this section, in order to qualify as a producer's loan, the proceeds of the loan need not be traced to an investment in any specific asset.

(iii) *Unrelated borrower.* For purposes of applying this section, it is not necessary for a borrower to be a related person with respect to the DISC from which it receives a producer's loan, or a member of the same controlled group as the DISC.

(iv) *Unpaid balance of producer's loans.* For purposes of applying this section, the unpaid balance of producer's loans does not include the unpaid balance of any producer's loan to the extent the loan has been deducted or charged off by the DISC as totally or partially worthless under section 165 or 166.

(v) *Refinancing, renewal, and extension.* For purposes of applying this section, the refinancing, renewal, or extension of a producer's loan shall be treated as the making of a new loan which may qualify as a producer's loan only if the requirements of subparagraph (1) of this paragraph are met.

(vi) *Events subsequent to time loan is made.* The determination as to whether a loan qualifies as a producer's loan is made on the basis of the relevant facts taken into account for purposes of determining whether the loan was a producer's loan when made. Thus, for example, if the accumulated DISC income of the lender is later reduced below the unpaid balance of all producer's loans previously made by the DISC, such subsequent decrease in the amount of accumulated DISC income will not result in later disqualification of such loan (or part thereof) as a producer's loan. Similarly, if a loan (or part of a loan) does not qualify as a producer's loan because of an insufficient amount of accumulated DISC income at the time the loan is made, a subsequent increase in the amount of accumulated DISC income will not result in later qualification of such loan (or part thereof) as a producer's loan. As a further example, for purposes of applying the borrower's export related assets limitation described in paragraph (b) of this section, a loan which qualifies as a producer's loan when made will not later be disqualified if