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Guidance for Complying with the Bureau of Industry and Security's Procedures for Reporting on Offsets Agreements Associated with the Sales of Weapon Systems or Defense-Related Items to Foreign Countries or Foreign Firms

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Background

Offsets are the practice by which the award of defense contracts by foreign governments or companies is conditioned upon commitments from the defense contractor to provide some form of compensation to the purchaser. In defense trade, offsets can include activities such as mandatory co-production, credit assistance, licensed production, subcontractor production, technology transfer, purchases, training, and foreign investment.

The use of offsets is commonplace in global defense trade. Today, virtually all of United States' defense trading partners impose some type of offset requirement. Countries require offsets for a variety of reasons including easing the burden of large defense purchases on their economy, increasing or preserving domestic employment, obtaining desired technology or promoting industrial sectors.

In 1984, the U.S. Congress added Section 309 on offsets in defense trade to the Defense Production Act (DPA) (50 U.S.C. app § 2099), requiring the President to submit a report to Congress on the impact of offsets on the defense preparedness, industrial competitiveness, employment, and trade of the United States. This provision has subsequently been amended, most recently in 2009 as Section 723 (U.S.C. App. § 2172), but the purpose of the report remains the same. Since 1992, the Secretary of Commerce has been the President's Executive Agent for carrying out Section 723 responsibilities. Section 723 authorizes the Secretary of Commerce to develop and administer the regulations necessary to collect offset data from U.S. firms. The Secretary of Commerce has delegated this authority to the Bureau of Industry and Security (BIS), which implements Section 723 through the [Offset Reporting Regulation, 15 CFR Part 105](#).

Who must report?

Any U.S. firm that enters into a contract to provide defense articles or defense services to a foreign country or foreign firm pursuant to an offset agreement exceeding \$5 million in value must report that agreement. In addition, U.S. firms must also report each offset transaction completed in performance of existing offset commitments for which offset credit of \$250,000 or more has been claimed from a foreign representative.

As noted in § 701.4(b) of BIS's [Offset Reporting Regulation](#), U.S. firms must only report to BIS on offset agreements that they are directly responsible for reporting to the foreign customer, regardless of who performs the transaction. In other words, prime contractors must report for their subcontractors if the subcontractors are not direct parties to the offset agreement.

In addition, U.S. firms should not report to BIS on offset agreements that their foreign subsidiaries or affiliates enter into with foreign countries if the U.S. firm is not a party to the offset agreement. However, if a foreign subsidiary or affiliate of a U.S. firm performs an offset transaction that is credited toward an offset agreement to which the U.S. firm is a party, the U.S. firm must report that transaction to BIS.

The deadline for reporting all new contracts and transactions signed or executed as described above is June 15th of the subsequent year in which they occurred.

Firms must submit their data in hardcopy to the Offset Program Manager, U.S. Department of Commerce, Bureau of Industry and Security, Room 3876, 14th Street and Constitution Avenue, N.W., Washington, DC 20230, and as an email attachment to OffsetReport@bis.doc.gov. Email attachments must include the information in a computerized spreadsheet or database format. All submissions must include a point of contact (name and telephone number).

Reporting on Export Sale and Related Offset Agreements

Reports must include the information described in § 701.4(c)(1) of BIS's [Offset Reporting Regulation](#). The following table format is provided to assist with the reporting of export sales and related offset agreements. Firms may add comments or explanations relating to the information as footnotes attached to the reports.

Suggested Format for Reporting on Export Sale and Related Offset Agreement

Name of country purchasing weapon	Name or description of weapon	Month that the offset	Military export sale classification (NAICS 6-digit code)	Foreign party to the offset agreement (identify the	Value of the export sale (if the sale involves	Total value of the offset agreement	Terms of the agreement (in months)	Offset agreement penalties for non-performance
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system or service	system/ service	was signed		foreign government agency or branch that is signatory to the offset agreement	more than one NAICS code, list each code and the associated value		(e.g., liquidated damages, debarment from future contracts, added offset requirements, fees, bank credit guaranties, or other)
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Reporting On Offset Transactions

Reports on offset transactions must include the information described in § 701.4(c)(2) of BIS's **Offset Report Regulation**. U.S. firms are required to provide an itemized list of offset transactions completed during the reporting period. The list should include the elements listed below for each such transaction (numerical estimates are acceptable when actual figures are unavailable; estimated figures shall be followed by the letter "E"). The following table format is provided to assist with the reporting of offset transactions.

Suggested Format for Reporting on Offset Transactions

Date (month and year) the original offset agreement was signed)	Name of foreign country involved in the military export sale	Name of offset performing entity	Name of country in which offset was fulfilled	Name of offset receiving entity (entity receiving benefits from the transaction)	Actual value of the transaction	Credit value of the transaction	Description of offset transaction category (co-production, tech transfer, subcontract, training, purchase, cash payment, etc.)	Offset transaction classification (6-digit NAICS code (s))	Offset transaction type (direct or indirect)
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Terms Used in Reporting on Offsets

The following definitions are provided to assist with the classification and reporting of offset activities:

Offset Agreement: An offset agreed to by the U.S. firm in order to conclude a military export sales contract. The agreement is normally reflected in a contract that specifies the percentage of the total defense-related export sale to be offset, the forms of industrial compensation required, the duration of the offset agreement, and penalty clauses, if any.

Offset Transaction: Any activity for which the U.S. firm claims credit for full or partial fulfillment of an offset agreement. For the purpose of analysis, BIS divides offset transactions into nine different categories, which are defined in the "Types of Transaction" section below.

Direct Offsets: Offset transactions that are directly related to the article(s) or service(s) exported or to be exported pursuant to the military export sales agreement. Direct offsets are usually in the form of co-production, subcontracting, training, production, licensed production, or possibly technology transfer or financing activities.

Indirect Offsets: Offset transactions that are unrelated to the article(s) or service(s) exported or to be exported pursuant to the military export sales agreement. The kinds of offsets that may be considered "indirect" include purchases, investment, training, credit assistance, and technology transfer.

Actual Value of Offset Transactions: The U.S. dollar value of the offset transaction in U.S. dollars without taking into account multipliers or intangible factors.

Credit Value of Offset Transactions: The U.S. dollar value credited for the offset transaction by application of a multiplier, any intangible factors, or other method. The credit value may be greater than, equal to, or less than the actual value of the offset.

Multiplier: A factor applied to the actual value of certain offset transactions to calculate the credit value earned. Foreign purchasers use multipliers to provide firms with incentives to offer offsets that benefit targeted areas of economic growth. When a (positive) multiplier is applied to the price of a service or product offered as an offset, the defense firm receives a higher credit value toward fulfillment of an offset obligation than would be the case without application of a multiplier. Conversely, foreign purchasers may apply "negative" multipliers to discourage certain types of transactions not considered to be in the best economic interest of the receiving entity.

Types of Transactions:

Co-production: Transactions that are based upon government-to-government agreements authorizing the transfer of technology to permit foreign companies to manufacture all or part of U.S.-origin defense articles. Such transactions are based upon an agreement specifically referenced in Foreign Military Sales (FMS) Letters of Offer and Acceptance (LOA) and a government-to-government Memorandums of Understanding (MOU). Co-production is always classified as a direct offset.

Credit Assistance: Credit assistance includes direct loans, brokered loans, loan guarantees, assistance in achieving favorable payment terms, credit extensions, and lower interest rates. Credit assistance specifically excludes the use of "banked" offset credits (credits that exceed the requirement of the offset agreement and are permitted, by the terms of the agreement, to be applied to future offset obligation). Credit assistance is nearly always classified as an indirect offset transaction but can also be direct.

Investment: Investment arising from an offset agreement, often taking the form of capital dedicated to the establishment of a foreign entity unrelated to the defense sale or to expanding the U.S. firm's subsidiary or joint venture in the foreign country. Investment can be either direct or indirect.

Licensed Production: Overseas production of a U.S.-origin defense article based upon the transfer of technical information under direct commercial arrangements between the U.S. manufacturer and the foreign government or producer. Licensed production is not pursuant to a co-production agreement specifically referenced in an LOA and co-production MOU. In addition, licensed production almost always involves a part or component for a defense system, rather than a complete defense system. Licensed production transactions can be either direct or indirect.

Purchases: Purchases involve the procurement of off-the-shelf items from the offset recipient. They are indirect transactions.

Subcontracting: In the offset context, subcontracting is the overseas production of a part or component of a U.S.-origin defense article. The subcontract does not necessarily involve the licensing of technical information. Instead, it is usually a direct commercial arrangement between the defense prime contractor and a foreign producer.

Technology Transfer: Transfer of technology that occurs as a result of an offset agreement and that may take the form of research and development conducted abroad, technical assistance provided to the subsidiary or joint venture of overseas investment, or other activities under direct commercial arrangement between the defense prime contractor and a foreign entity.

Training: Generally includes training related to the production or maintenance of the exported defense item. Training, which can be either direct or indirect, may be required in unrelated areas, such as computer training, foreign language skills or engineering capabilities.

Updated Offset Reporting Regulation

On December 23, 2009, BIS published a **final rule** in the *Federal Register* updating its Offset Reporting Regulations. The December 23, 2009 rule clarifies the information BIS is seeking to receive from industry and requires that industry provide more precise information on the industry sectors in which offset activity occurs. Firms reporting pursuant to the Offset Reporting Regulation must use the requirements in the final rule.

The December 23, 2009 rule's most significant new data requirement is that U.S. firms must classify products and services involved in offset agreements and transactions triggering a reporting requirement by six-digit North American Industry Classification System (NAICS) code. NAICS is the standard industrial classification system used in the United States. Prior to the publication of the December 22, 2009 rule, BIS required industry to classify offset transactions by broad industry classification and to provide a name, date, and description of the military export sale. BIS directed firms to use the Standard Industrial Classification (SIC) codes for assistance in identifying an appropriate category for offset agreements and transactions. The SIC was replaced by the NAICS in 1997 (See 62 FR 17288, Apr. 4, 1997).

All companies conducting business with the U.S. Government, including those involved in military export sales with associated offset contracts, are required to classify their products and services in accordance with the NAICS. The U.S. Census Bureau posts instructions **on its web site** on how to properly classify products and services in accordance with the NAICS. The Census web site also contains a search feature that allows users to identify NAICS codes for their products and services based upon a keyword search. BIS's December 23, 2009 rule also lists illustrative examples. Note that if an offset agreement or transaction involves more than one NAICS code, firms should report all of the appropriate codes as well as the value of the transaction related to each NAICS code.

The December 23, 2009 rule also updates the definitions used by firms in preparing their submissions for BIS. For example, the definition of "offset transaction" in § 701.2(f), removes reference to activities not commonly reported to BIS (i.e., countertrade, barter, counterpurchase, and buy back) and adds reference to frequently reported activities (i.e., credit assistance, training, and purchases).

The December 23, 2009 rule also provides additional clarity for U.S. firms by adding examples for each type of offset transaction found in the illustrative list in § 701.2(f). For instance, Example 1 to § 701.2(f), clarifies that "co-production" includes transactions that are based upon government-to-government agreements authorizing the transfer of technology necessary for a foreign company to manufacture all or part of a U.S.-origin defense article. Such transactions are based upon agreements specifically referenced in Foreign Military Sales ("FMS") Letters of Offer and Acceptance (LOA) and government-to-government co-production Memorandums of Understanding. If the LOA does not specifically address the transfer of technology, then the transaction is more appropriately classified as "licensed production."

Additionally, in Example 4 to § 701.2(f), BIS clarifies that a U.S. company making arrangements for a line of credit at a financial institution should be classified as "credit assistance" (distinguishable from the use of credited or "banked" offset credits, which would be classified as "other").

In order to clarify the individual status of performance measures and non-performance penalties, the December 23, 2009 rule separates their reporting requirements by moving them from old § 701.4(e)(1)(vii) to new § 701.4(c)(1)(viii) and new § 701.4(c)(1)(ix), respectively. The rule also includes lists of examples for each.

New § 701.4(c)(2)(ii) requires companies to report for each offset transaction the date when the related offset agreement was signed. This data will allow BIS to better track the fulfillment of offset agreements and to identify trends in offset transaction activity.

Finally, the December 23, 2009 rule adds new § 701.6 describing the penalties available under the Defense Production Act (50 U.S.C. App. 2155) should companies not comply with BIS's regulation. Willful violation of the Defense Production Act may result in punishment by fine or imprisonment, or both. The maximum penalty provided by the Defense Production Act is a \$10,000 fine, one year in prison, or both. The U.S. Government may also seek an injunction from a court of appropriate jurisdiction to prohibit the continuance of any violation of, or to enforce compliance with, the Defense Production Act.

Do you need additional help?

You may contact Ron DeMarines, Offset Program Manager, at (202) 482-3755 or (202) 482-4506, or by email at ronald.demarines@bis.doc.gov for assistance.

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