

## **New Manufacturing and Construction Deduction**

One of the most beneficial code sections created by Congress under The American Jobs Creation Act of 2004 is Code section 199 (effective for tax years beginning after December 31, 2004) which provides a deduction for U.S. corporations engaging in certain manufacturing activities.

For 2005 and 2006, section 199 allows a deduction equal to 3% of the lesser of the qualified production activities income or taxable income. The deduction increases to 6% for 2007, 2008, and 2009, and 9% for subsequent tax years. The amount of the deduction is also limited to 50% of the Form W-2 wages actually paid to employees and reported by the employer during the tax year.

Only the qualified production activities income attributable to the actual conduct of a trade or business is eligible for the deduction. Under the Code section, qualified production activity income is defined as the taxpayer's domestic production gross receipts for the tax year minus the sum of (1) the cost of goods sold allocable to those receipts, (2) deductions, expenses or losses directly allocable to those receipts, and (3) a ratable portion of deductions, expenses, or losses not directly allocable to those receipts or to another class of income.

Qualified domestic production gross receipts are derived from a limited number of activities which include:

- Any lease, rental, license, sale, or exchange of:
  1. Tangible personal property manufactured, produced, grown, or extracted by the taxpayer within the United States.
  2. Film production in the United States.
  3. Electricity, natural gas, or potable water produced in the United States.
- Construction performed in the United States.
- Engineering or architectural services performed in the United States for construction projects in the United States.

Partnerships and S corporations are not allowed to take the deduction at the entity level. Instead, the deduction is allowed as a deduction on the partner's or shareholder's tax return, based on information provided on Schedule K-1.

The Code section is very complex and vague on many terms. The IRS and the Treasury has issued Notice 2005-14 which provides some guidance and clarification. In addition, the IRS has released proposed regulations covering many key issues.

*If you would like more information on how this relates to your situation, please feel free to contact Michael Stein at 312-384-4285 or via e-mail at [mstein@legacypas.com](mailto:mstein@legacypas.com).*