Section 199 – Income Attributable to Domestic Production Activities

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I. Introduction

a. A replacement for FSC/ETI export benefits; but not an export-specific benefit. Requires sufficient U.S.-based "production" activity.
b. Not limited to U.S. "manufacturing" in the traditional sense
c. A unique deduction – Not based on an item of expense
d. Policy goal -- encourage U.S.-based production activities and job creation
e. A significant ETR driver for many companies
f. Complexity and tax department resource constraints prevent many companies from claiming the benefit fully.
g. An "80% solution" has been adopted (intentionally or unintentionally) by many taxpayers.
h. Because of the taxable income ("TI") limitation (discussed below), the benefit may be reduced as a result of other incentives and policy objectives (e.g., bonus depreciation and pension funding)

II. Basic Section 199 Mechanics

a. Qualified Production Activities Income ("QPAI") X 9% = Domestic Production Activities Deduction ("DPAD")
b. QPAI = Domestic Production Gross Receipts ("DPGR") – [Cost of Goods Sold ("CGS") allocable to DPGR + other expenses, losses, and deductions properly allocable to DPGR]
c. If TI is less than QPAI, must use TI (generally after taking into account any NOL carryback or carryforward, and with adjustment for DPAD). See §§1.199-1(a) and -1(b).
d. DPAD cannot exceed 50% of W-2 wages properly allocable to DPGR. See §1.199-2 and the final section of this outline.
e. Only a 6% rate for "oil related QPAI," i.e., QPAI attributable to production, refining, processing, transportation, or distribution of oil, gas, or any "primary product" thereof. See §§199(d)(9) and 927(a)(2)(C) (prior to repeal).

III. Domestic Production Gross Receipts -- §1.199-3

a. To qualify as DPGR, "gross receipts" must satisfy all aspects of a multi-part definition (see §1.199-3(a)); but consider the "less than 5% *aggregate* non-DPGR de minimis rule" (see §1.199-1(d)(3)).
b. The qualification determination is made on an "item-by-item" basis. See §1.199-3(d)(1). The relevant "items" are dictated by the taxpayer's business practices. Need to understand how products are offered to customers in the normal course of the business operations.
c. A broadly-defined "item" (i.e., qualified and non-qualified property sold as a single unit) may enhance DPGR. See §1.199-3(d)(2)(i). See also TAM 201049029 (12/10/2010) ("programming packages" licensed by taxpayer may be treated as a single item despite inclusion of third-party-produced films).
d. Consider "shrink back" if a more broadly-defined item does not qualify. The analysis then would be on a component-by-component basis. See §1.199-3(d)(1)(ii) and examples in §1.199-3(d)(4). See CCA 201246030 (11/16/2012) (if taxpayer cannot qualify blister packs containing third-party pills, taxpayer should be able to qualify the blister packs themselves). May carve out as DPGR a reasonable portion of a single price (e.g., spare parts used in order to satisfy a warranty obligation).
e. The critical elements of the DPGR definition are described below.
f. "*Gross receipts directly derived from lease, rental, license, sale, exchange, or other disposition of qualifying production property* ("QPP")"
    a. "Gross receipts" is a defined term. See §1.199-3(c).
    b. Specific identification of qualified gross receipts is required if information is readily available. See §1.199-1(d)(2).
    c. In lieu of specific identification – "Any reasonable method satisfactory to the Secretary based on all the facts and circumstances." See §§1.199-1(d)(1) and -1(d)(2). Each taxpayer may have a unique, "negotiated" approach for identifying DPGR.
    d. Substance over form – A transaction may be a lease, license, sale, service, or a combination thereof, depending on its substance. (See, e.g., TAM 201314043 (4/5/2013) (Government asserts contract is both a production contract (DPGR) and a contract for the development of intangibles (non-DPGR)).
    e. Should consider all the bundled pricing that may exist and all the de minimis services that might produce DPGR.
    f. Embedded services generally do not generate DPGR; but see exceptions for certain services when price is not separately stated and the service is not sold separately nor separately bargained for in normal course of the taxpayer's business (warranty, delivery, operating manuals, installation, and qualified software maintenance agreements). See §§1.199-3(i)(4)(i)(B)(1)-(5).

g. Also consider the "less than 5% *per item* rule" when services and/or nonqualified property are not priced separately from qualified property and are not separately offered or bargained for in normal course. See §1.199-3(i)(4)(i)(B)(6).
h. Financing and interest components of a lease generally are DPGR. See §1.199-3(i)(1)(ii).
i. Related person rule with respect to leases/licenses – See §§1.199-3(b)(1) and (b)(2)
j. Certain "income substitutes" are DPGR (business interruption insurance proceeds; government subsidies; government payments not to produce). See §1.199-3(i)(1)(iii).
k. If a sale would have produced DPGR, the value of property received in a taxable exchange is DPGR. See §1.199-3(i)(1)(iv). If taxpayer receives eligible property (i.e., oil, natural gas, petrochemicals, and products produced therefrom) in a taxable exchange and then sells the eligible property, taxpayer generally may determine the amount of the DPGR based on the value of the eligible property either on the date of the taxable exchange or the date of the subsequent sale.
l. DPGR excludes revenue from non-operating mineral interests. See §1.199-3(i)(9).
m. Hedging transactions – If the risk being hedged is with respect to property described in §1221(a)(1) (inventory) or §1221(a)(8) ("supplies"), and such property relates to DPGR, gain or loss must be taken into account in determining DPGR or CGS allocable to DPGR, as appropriate. See §1.199-3(i)(3).
n. QPP includes tangible personal property, computer software, and sound recordings. See §1.199-3(j).
o. QPP excludes land. QPP also generally excludes food and beverages prepared at a retail establishment. See §1.199-3(o).
p. DPGR generally excludes revenue from services (subject to important exceptions) and classes of income considered to be "passive" (e.g., dividends and royalties).
q. Advertising and product-placement income generally do not qualify as DPGR. But see important exceptions in §1.199-3(i)(5)(ii) that apply to qualified films, computer software, and certain printed publications.
r. Guaranteed payments to partners are not DPGR. See §1.199-3(p).
s. Self-constructed assets – Consider revenue from asset divestitures. See CCA 201208029 (2/24/2012) (gross receipts from sale of self-constructed natural gas well are DPGR; but sale of leasehold rights does not qualify).

g. "*Manufactured, Produced, Grown, or Extracted*" ("MPGE") -- §1.199-3(e)
a. Manufacturing, producing, growing, extracting, installing, developing, improving and creating QPP; making QPP out of scrap, salvage, or junk, or from new or raw material, by processing, manipulating, refining, changing the form of an article, or by combining or assembling two or

more articles; cultivating, raising, fishing, and mining; and certain storage, handling, or processing of agricultural products.

b. Installation is a qualified activity if the property is MPGE by the taxpayer, and the taxpayer has the benefits and burdens of ownership ("BBO") during installation. See §§1.199-3(e)(3), and -3(e)(5) example 4.
c. "Packaging and repackaging" generally does not qualify as an MPGE activity; but see CCA 201246030 (11/16/2012) (automated packaging process is an MPGE activity).
d. For a discussion of "changing the form of an article," or "combining two or more articles," but not merely "packaging and repackaging," see U.S. v. Dean, 112 AFTR 2d 2013-5592 (DC CA 2013) (creation of gift baskets and gift "towers" from various products and packaging produced by third parties).

h. "*By the taxpayer*" -- §1.199-3(f)
   a. Generally must have BBO while goods are MPGE. With BBO, taxpayer can MPGE based on the activities of a contract manufacturer. See §1.199-3(g)(1).
   b. See ADVO, Inc. & Subsidiaries v. Commissioner, 141 TC 298 (2013) (taxpayer failed to establish it had BBO of printed direct mail advertising materials when such materials were produced).
   c. Government contractor "FAR clause" exception – See §1.199-3(f)(2).
   d. Qualifying in-kind partnership – attribution rule for partners and partnerships engaged solely in oil, natural gas, petrochemicals, electricity, or otherwise designated in Internal Revenue Bulletin, provided the QPP is distributed to the partner and the partner is a partner when the QPP is sold/leased. See §1.199-3(i)(7).
   e. Attribution rules for partners, partnerships, and EAG partnerships. See §§1.199-5(g) and -3(i)(8).
   f. Attribution generally is not available for construction or engineering/architectural services, except within a consolidated group. See §§1.199-3(i)(8)(ii)(C) and -7(d)(2).

i. "*In whole or in significant part*" -- §1.199-3(g)
   a. Applies to the "by the taxpayer" requirement and the "within the U.S." requirement.
   b. Activities must be "substantial in nature taking into account all of the facts and circumstances." Consider relative value added by, and relative cost of, the taxpayer's activities in the U.S. Also consider the nature of the QPP and the nature of the taxpayer's activities.
   c. R&D and creation of intangibles generally are not taken into account in the "substantial in nature" analysis; but see exception (in §1.199-3(g)(3)(iii)) for creation of software and sound recordings. See CCA 201313020 (3/29/2013) (design and development activities for an online book did not constitute the MPGE of QPP).

d. Under a safe harbor, taxpayer is treated as manufacturing QPP "in whole or in significant part" if the direct labor and overhead to MPGE the QPP in U.S. is 20% or more of the CGS of the QPP. For this purpose, "overhead" generally is all section 263A cost other than direct materials and direct labor. In transactions without CGS (e.g., a lease), the safe harbor is applied by reference to the QPP's "unadjusted depreciable basis."
e. If taxpayer has BBO while QPP is produced (in whole or in part) by a contract manufacturer, the substantial in nature test and the safe harbor are applied by reference to the activities and direct labor and overhead of both the taxpayer and the contract manufacturer. See §1.199-3(g)(4).
f. Special aggregation rules apply in the case of EAGs, EAG partnerships, and qualifying in-kind partnerships. See §1.199-3(g)(4)(ii).

j. "*Within the United States*" -- §1.199-3(h)
   a. "Manufacturing" can start or end outside U.S. and still produce DPGR, provided there is sufficient U.S.-based activity
   b. 50 states and District of Columbia
   c. Includes territorial waters (12 nautical miles from coastline), and seabed and subsoil of those submarine areas adjacent to the territorial waters over which the U.S. has exclusive rights of exploration and exploitation of natural resources (200 miles from coastline)
   d. Excludes possessions and territories of the U.S.

k. Qualified Film -- §1.199-3(k)
   a. Motion picture film or video tape under §168(f)(3), or live or delayed television programming
   b. To constitute a qualified film, 50% or more of the compensation expense for production generally must be for U.S.-based services (includes amounts paid to a broad array of personnel required for production).
   c. The methods and means of distribution generally do not affect availability of the §199 deduction. Must read §1.199-3(k)(3)(ii) in light of §199(c)(6) (as amended in 2008). As of 2014, certain examples in the regulations have not been amended to reflect this rule.
   d. Compensation includes amounts paid to independent contractors, and includes participations and residuals (see §167(g)(7)).
   e. To qualify as DPGR, the gross receipts must be derived from a qualified film "produced by the taxpayer." See §§1.199-3(a)(1)(ii) and -3(k)(6).
   f. Production activity by the taxpayer must be "substantial in nature," or the taxpayer must satisfy the requirements of a safe harbor. See §§1.199-3(k)(6) and (k)(7). The substantial in nature test generally is applied by disregarding the requirement that the production activity must be within the U.S. Attribution and aggregation rules apply. See, e.g., §1.199-3(g)(4) (as modified by -3(k)(6)) and §199(d)(1)(A)(iv).
   g. Safe harbor in §1.199-3(k)(7) addresses the "qualified film" requirement and the "produced by the taxpayer" requirement. Not less than 50% of

the total compensation paid by the taxpayer must be for services performed in the U.S., and the taxpayer must satisfy the "20% or more direct labor and overhead" test in §1.199-3(g)(3). Attribution and aggregation rules apply, and the direct labor and overhead of the taxpayer to produce the film must be within the U.S.

h. See CCA 201446022 (11/14/14) (Service asserts that license fees paid to producers of third-party content do not constitute "overhead"). The CCA also discusses the application of the "unadjusted depreciable basis" rule in the context of a transaction (i.e., a license) that does not involve cost of goods sold. See also the reference in §1.199-3(k)(7)(i) to any section 181 election.
i. Sale of film-themed merchandise is sale of tangible personal property, not revenue derived from a qualified film.
j. Revenue from a license of the right to exploit film characters is not gross receipts from a qualified film.
k. See §1.199-3(k)(8) for a BBO rule applicable to contracted production
l. DPGR includes advertising income and product placement income.
m. See §199(d)(1)(A)(iv) for an attribution rule that applies in the case of pass-thru entities
n. See CCA 201446022 (11/14/2014) (application of qualified film rules to "subscription packages" distributed by taxpayer who produced some of the content).

l. Electricity, natural gas, or potable water ("Utilities") – §1.199-3(l)
   a. DPGR generally include gross receipts from electricity, natural gas, and potable water.
   b. The natural gas must be extracted from a natural deposit. Production activities include all activities involved in extracting the gas and processing it into pipeline quality gas.
   c. Gross receipts attributable to transmission and distribution activities generally are non-DPGR, subject to a 5% de minimis rule
   d. If the taxpayer (including related persons) is engaged in production and transmission/distribution activities, the taxpayer must allocate gross receipts among DPGR and non-DPGR.

m. Construction of real property – §1.199-3(m)
   a. Taxpayer must be engaged in the active conduct of a construction trade or business on a regular and ongoing basis. See NAICS code 23 and other NAICS codes that include construction activity, such as NAICS code 213111 (drilling oil and gas wells) and NAICS code 213112 (support activities for oil and gas operations).
   b. "Construction" includes "activities and services" relating to the construction or erection of real property. Such activities and services also may relate to a project to substantially renovate real property.

c. Activities the cost of which qualify as (i) intangible drilling and development costs (§1.612-4) or (ii) development expenditures for a mine or natural deposit (§616) constitute construction activities.
d. Activities constituting construction include activities of a type typically performed by a general contractor (e.g., management, approvals, and inspection).
e. Tangential services (e.g., hauling trash and delivering materials) are construction activities if performed by a taxpayer engaged in other construction activities relating to the project.
f. When performed in connection with "construction of real property," landscaping, painting, grading, demolition, excavating, and other activities that physically transform the land are activities constituting construction.
g. "Real property" includes buildings, structural components of buildings, inherently permanent structures (§1.263A-8(c)(3)), structural components of inherently permanent structures, inherently permanent land improvements, oil and gas wells, and infrastructure. See CCA 201302017 (1/11/2013) (discussion of the definition of "inherently permanent structure").
h. Structural components include walls, partitions, doors, wiring, plumbing, central air conditioning and heating systems, pipes and ducts, elevators and escalators, and other similar property.
i. Infrastructure includes roads, power lines, water systems, railroad spurs, communication facilities, sewers, sidewalks, cable and wiring, and inherently permanent oil and gas platforms.
j. Substantial renovation means the renovation of a major component or substantial structural part of real property that materially increases the value of the property, substantially prolongs the useful life of the property, or adapts the property to a new or different use.
k. See *Gibson & Associates, Inc. v. Commissioner*, 136 TC 195 (2011) (Tax Court addresses qualification of various construction and infrastructure projects).
l. The "item" that constitutes the "construction project" for a particular taxpayer is determined under any reasonable method. See §1.199-3(d)(2)(iii).
m. Gross receipts from a "qualified construction warranty" are DPGR.
n. Engineering and architectural services are not "construction," but may qualify under §1.199-3(n).
o. DPGR does not include receipts attributable to land. See land safe harbor — Reduce CGS by "land costs," and reduce DPGR by land costs plus a percentage determined by reference to the number of months the taxpayer owned the land.
p. 5% de minimis rule applies on a per project basis. May exclude revenue from land sale for purposes of the de minimis rule if applying the land safe

harbor or another reasonable method for allocating gross receipts attributable to land to non-DPGR

q. No BBO requirement

n. Engineering or architectural services performed in U.S. for a construction project – See §1.199-3(n)
   a. The services must be performed in connection with a construction project described in §1.199-3(m)(1)(i).
   b. Taxpayer must be engaged in a trade or business considered engineering or architectural services on a regular and ongoing basis. See, e.g., NAICS code 541330 (engineering services) and NAICS code 541310 (architectural services).
   c. Engineering – professional services requiring engineering education, training, and experience and application of specialized knowledge of mathematical, physical, or engineering sciences (consultation, investigation, evaluation, planning, design, or supervision)
   d. Architectural – professional services such as consultation, planning, aesthetic and structural design, drawings and specs, or supervision of construction (for the purpose of assuring compliance with plans, specifications, and design)
   e. Gross receipts are DPGR even if the construction project ultimately is not undertaken or is not completed.
   f. 5% de minimis exception

o. Computer software -- See §§1.199-3(i)(6) and -(j)(3)
   a. A sale or license of computer software generally will generate DPGR (provided the other elements of the DPGR definition are satisfied).
   b. "Computer software" means any program or routine or any sequence of machine-readable code designed to cause a computer to perform a desired function(s)
   c. Includes machine-readable code for video games, for equipment that is an integral part of other property, and for typewriters, calculators, adding and accounting machines, copiers, duplicating equipment, and similar equipment, regardless of whether the code is designed to operate on a computer.
   d. Internet/software-driven services (e.g., customer and technical support, on-line banking, telecommunication services, internet access services, and online books) do not generate DPGR.
   e. Online software -- Gross receipts from customer access to computer software for the customer's *direct use while connected to the Internet* qualify as DPGR if the taxpayer derives on a regular and ongoing basis receipts from sale/lease/license of software MPGE U.S. with only minor or immaterial differences from the online software, and such similar software has been provided to customers either affixed to a tangible medium or is available for download.

f. Online software also qualifies if *another person* sells/leases/licenses substantially identical software via tangible medium or download. Software is substantially identical if it provides the same functional result and has a significant overlap of features or purpose. All computer software games are deemed to be substantially identical.
g. The de minimis rule for qualified computer software maintenance agreements does not apply in the case of online software. See §1.199-3(i)(4)(i)(B)(5).
h. Advertising income and product-placement income in connection with online software is not DPGR.

IV. Cost of Goods Sold -- §1.199-4(a) and (b)

a. Cost of goods sold ("CGS") is determined under the methods of accounting the taxpayer uses to compute taxable income.
b. "CGS is equal to beginning inventory plus purchases and production costs incurred during the taxable year and included in inventory costs, less ending inventory."
c. §1.199-4(b)(1) – "A taxpayer determines its CGS allocable to DPGR in accordance with this paragraph (b) . . ."
d. "*CGS allocable to DPGR* may include the inventory cost of QPP that will, or has, generated DPGR even though the gross receipts from the sale of the QPP may be, or have been, included in gross income for a different taxable year."
e. Treasury recognized there will not be a perfect match between year of income inclusion and year the purchases and/or production costs are incurred. If CGS are related to QPP that produces DPGR, the CGS should be allocated to DPGR.
f. "Deemed DPGR" – If receipts are treated as DPGR, then CGS must be allocated to such DPGR. (This refers to DPGR from the overall 5% de minimis rule, de minimis embedded services, de minimis transmission/distribution, construction de minimis rule, engineering/architectural de minimis rule, and the food/beverage de minimis rule.)
g. §1.199-4(b)(2)(i) – "Allocating Cost of Goods Sold" -- A reasonable method satisfactory to the Secretary based on all of the facts and circumstances.
    a. Specific identification based on information readily available; but not required to incur undue burden or expense
    b. Consider apportionment based on gross receipts, units sold, or units produced
    c. Should consider whether all costs attributable to non-DPGR have been associated with non-DPGR (including indirect costs)
    d. Imported items – CGS is the arms-length transfer price or value when entering the U.S. (subject to a special rule for property exported for further manufacture and then reimported).

e. Must allocate inventory valuation adjustments (e.g., lower of cost or market)

h. §1.199-4(b)(2)(ii) – If a taxpayer recognizes and reports gross receipts on a Federal income tax return for a taxable year, and incurs CGS "related to such gross receipts" in a subsequent taxable year, taxpayer must allocate the CGS to (A) DPGR if taxpayer identified the related gross receipts as DPGR in the prior year, or (B) non-DPGR if the related gross receipts were identified as non-DPGR in the prior year, or if the receipts were recognized in a [pre-2005] year. (For a poorly-reasoned interpretation of this rule, see CCA 200946037.)

i. Rules for inventories valued at market or bona fide selling prices (§1.199-4(b)(4))

j. Rules applicable to inventories accounted for under the LIFO inventory method (§1.199-4(b)(5))

k. Simplified production method or simplified resale method for additional 263A costs (§1.199-4(b)(6))

V. Other Expenses, Losses, or Deductions -- 1.199-4(c) and (d)

a. Taxpayers generally must determine deductions allocable to DPGR using the rules contained in §§1.861-8 through 1.861-17 and 1.861-8T through 1.861-14T (the "section 861 method"). See §1.199-4(a).

b. A summary of the allocation and apportionment rules in the section 861 regulations is beyond the scope of this outline. Taxpayers should be aware, however, that the application of the section 861 method is a major driver of DPAD results.

c. See the consistency rule in §1.861-8(f)(2)(i)

d. Simplified deduction method (annual average gross receipts of $100M or less, or total assets of $10M or less)

e. Small business simplified overall method (average annual gross receipts of $5M or less, and certain cash basis taxpayers)

f. An accurate DPAD calculation requires an annual analysis of "below the line" deductions. (See, e.g., lines 12-26 of Form 1120.)

g. Consider the impact of the section 861 affiliated group rules

h. The treatment of interest expense, R&D expense, taxes and licenses, selling expenses, and G&A costs almost always has a material impact on the DPAD result.

i. Interest expense – Methodology for section 199 purposes should be consistent with methodology for foreign tax credit purposes, but the assets relevant for apportionment purposes in connection with each of the operative sections are likely to be different. The apportionment method should consider all assets that generate income or reasonably could be expected to generate income.

j. If QPAI and W-2 wages of a partnership must be combined with total QPAI and W-2 wages from other sources, then for interest expense apportionment

purposes the taxpayer's interest in the partnership and the partnership's assets are disregarded. See §1.199-4(d)(5).

k. R&D – The rules of §1.861-17 are applied, but without the exclusive apportionment rule of 1.861-17(b). See §1.199-4(d)(3).
l. Selling expenses – As with any apportioned expenses, taxpayers need to thoroughly consider all the consequences of their apportionment methodology.
m. Charitable Contributions – Are ratably apportioned based on gross income attributable to DPGR and non-DPGR. See §1.199-4(d)(2).
n. Taxpayers generally may change allocation and apportionment methodologies without IRS consent since such methodologies are not methods of accounting. See §1.199-8(a).

VI. Prior Period Costs

a. Prior Period Compensation Expenses. Taxpayers should evaluate whether compensation deductions are related to DPGR. To the extent related to non-DPGR, the deductions should not reduce QPAI. The relationship is not determined based on the year in which the deduction is properly claimed for tax purposes. Rather, the relationship generally depends on whether the expense generated DPGR.
    a. Stock option expense
    b. Bonuses
    c. Qualified and non-qualified pension expense
    d. Other post-retirement employee benefits
    e. FICA
b. Non-compensatory Prior Period Costs. Essentially the same analysis as for prior period compensation expenses.
    a. Judgments, settlements, attorney's fees, and other legal costs
    b. Environmental remediation expenses
    c. State tax payments
    d. Other costs linked to pre-2005 activity
c. See CCA 200946037 (Service contends that amounts in CGS may not be treated as prior period costs). Taxpayers should consider the factual relationship, if any, between an expense and DPGR.

VII. Pass-Thru Entities -- §§1.199-5 and 1.199-9

a. §1.199-5 – Tax years beginning after 5/17/06 (See §1.199-9 for tax years beginning on or before 5/17/06)
b. The section 199 deduction with respect to the qualified production activities of a partnership ("PS") generally is determined at the partner level.
c. In general, items are allocated to partners under PS rules, and then aggregated with the partner's items from outside the PS for purposes of allocating and apportioning deductions and calculating QPAI.

d. Determination of QPAI and W-2 wages may be made at the PS level in the case of certain eligible entities. See Rev. Proc. 2007-34.
e. In the case of eligible entities, a partner aggregates the QPAI and W-2 wages from the PS with its other QPAI and W-2 wages. Partner ignores PS items and attributes for purposes of calculating its own (i.e., non-PS) QPAI and for purposes of allocating and apportioning expenses. See §1.199-5(b)(1)(ii).
f. Disallowed losses and deductions generally are ignored. If allowed in a later year, the losses and deductions are taken into account in such later year. Losses or deductions that are disallowed for taxable years prior to 2005, are not taken into account if allowed in a later year.
g. Sale of PS interest, or distribution to a partner, could give rise to DPGR. See §1.199-5(f). Should check for unrealized receivables and substantially appreciated inventory under §§751(a) and (b).
h. Generally, no activity attribution to/from a partner; but see qualifying in-kind PS and EAG PS rules. Also see the attribution rule in §199(d)(1)(A)(iv) in the case of films produced by a partnership or a partner.
i. Need to be careful with section 721 transactions and other transactions between partner and PS. May wind up with gross receipts in the hands of a taxpayer that does not satisfy the "MPGE by the taxpayer" requirement.
j. See separate rules for S corporations, trusts, and estates.

VIII. Agricultural and Horticultural Cooperatives – §1.199-6

a. Patrons of cooperatives generally will receive written notice from the cooperative setting forth the portion, if any, of the cooperative's section 199 deduction that is being passed through to the patrons.
b. In order to pass the deduction through, the cooperative must have a section 199 deduction and must have made a "qualified payment" (generally, a patronage dividend) to the patron.

IX. Expanded Affiliated Groups – §1.199-7

a. EAG means an "affiliated group" *substituting more than 50%* and without regard to 1504(b)(2) (insurance companies) and (b)(4) (936 corporations). Insurance companies and 936 companies do not break affiliation (i.e., they are includible corporations for this purpose). Status is determined on a daily basis.
b. All "members" of an EAG generally are treated as a single corporation.
c. Except as otherwise provided, however, each "member" of an EAG is a separate taxpayer that computes its own TI (or loss), QPAI, and W-2 wages.
d. Attribution – If property was MPGE by another corporation(s) and the disposing member is a member of the same EAG as the MPGE member at the time the disposing member disposes of the QPP, the disposing member is treated as conducting the previous activities of the MPGE member. For lease, rental, or license the testing occurs at each income inclusion date. See §1.199-7(a)(3)(i).

e. Attribution generally does not apply for purposes of construction, engineering, or architectural services (but see §1.199-7(d)(2), permitting attribution within a consolidated group for activities occurring during the period of consolidation).
f. Computation of EAG's DPAD –
    a. Treat a consolidated group as a single member of the EAG
    b. If all EAG members are in a single consolidated group, DPAD is determined based on the consolidated TI, QPAI, and W-2 wages.
    c. Calculate each EAG member's separate TI (or loss), QPAI, and W-2 wages.
    d. Aggregate the EAG members' TI (or loss), QPAI, and W-2 wages
    e. If a member's current-year NOL reduces the EAG's TI (but not below zero), it is not treated as a carryover or carryback to any other taxable year for section 199 purposes. Thus, before concluding that a carryover or carryback has reduced or eliminated TI, should consider whether the NOL impacted EAG TI in the year the NOL arose.
g. Allocation of EAG DPAD –
    a. Allocate the EAG DPAD to each member based on the respective member's proportionate share of the EAG's QPAI.
    b. Allocate the consolidated group DPAD to each member of the consolidated group based on such member's proportionate share of the consolidated group's QPAI.
h. If a corporation becomes or ceases to be an EAG member during the year, an equal portion of TI (or loss), QPAI, and W-2 wages is assigned to each day of the corporation's taxable year. See §1.199-7(f).

X. Other Rules -- §1.199-8

a. Section 199 requires numerous allocations. Taxpayers may use any reasonable method based on all of the facts and circumstances, unless the section 199 regulations specify a method.
b. Coordination with alternative minimum tax. To compute alternative minimum taxable income ("AMTI"), a corporation must deduct an amount equal to 9 percent of the lesser of QPAI or AMTI. See §1.199-8(d).
c. Nonrecognition transactions. In the case of transactions described in §§351, 721, 731, and 1031, attribution generally does not apply (subject to exceptions for EAGs and EAG partnerships). In the case of corporate nonrecognition transactions described in §381(a), attribution does apply. See §1.199-8(e).
d. See §1.199-8(g) for rules regarding the treatment of §481 adjustments for purposes of section 199.
e. Losses and deductions generally do not impact DPAD to the extent such losses and deductions are disallowed. Losses and deductions disallowed prior to 2005 do not impact DPAD even if such losses or deductions subsequently are allowed. See §1.199-8(h).
f. See §1.199-8(i) for various section 199 effective dates.

XI. Selected DPAD Process Considerations

a. DPAD calculations tend to be overly reliant on process
    a. Tax department instructions and templates drive the results
    b. DPAD expertise and thorough understanding of business operations may be lacking
b. DPAD training and periodic reconsideration of the DPAD process are advisable
c. Periodic interviews with divisional controllers are advisable
    a. What drives the revenue?
    b. What drove the qualified/nonqualified determination (to the extent such determination was made at the business unit)?
    c. What costs are associated with the DPGR and non-DPGR?
    d. How are indirect costs being spread?
d. Need to consider whether transactions are being reported across multiple reporting units
    a. Is the revenue/expense from the entire transaction captured?
    b. Are intercompany eliminations adequately accounted for?
e. Should annually identify and analyze any unique revenue-generating transactions (e.g., asset divestitures)
f. Should annually identify and analyze any unique expense-generating events (e.g., a litigation settlement)
g. Should reconsider whether prior period costs are carefully and systematically allocated to non-DPGR
h. Should consider projected TI and the potential impact of timing items that reduce TI (e.g., bonus depreciation and pension funding)

XII. Wage Limitation -- §1.199-2

a. DPAD cannot exceed 50% of W-2 wages properly allocable to DPGR.
b. Most taxpayers incur very significant labor costs in connection with their section 199 activities and, as a result, do not have to reduce DPAD under this limitation.
c. Taxpayers should check their DPAD calculations annually to determine whether the W-2 wages impacting the determination of QPAI (including wages included in cost of goods sold) are at least 200% of the DPAD amount they intend to claim.
d. If W-2 wages impacting QPAI are less than 200% of DPAD, taxpayer should apply the wage expense safe harbor in §1.199-2(e)(2)(ii).
e. See Rev. Proc. 2006-47 (10/17/2006) for guidance as to “W-2 wages” under §199(b)(2)(A) (W-2 wages prior to allocation to DPGR).
f. See §199(b)(2)(D) for a rule applicable only to qualified films.
g. See §1.199-2(b) in the case of a short taxable year.
h. See §1.199-2(c) in the case of an acquisition or disposition of a trade or business.