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The Domestic Production Activities Deduction: Survey of Compiled Guidance

July 25, 2016

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Companies operating in a variety of industries have taken the domestic production activities deduction (the "DPAD") after maneuvering through the requirements found in section 199 and related guidance from the IRS and the courts.¹ This article provides a compendium of that guidance as a tool to assist taxpayers.

Set forth below is a compendium of the publically available determinations by the IRS and of the courts that have been asked to adjudicate controversies arising under section 199.² The compendium does not include the various iterations of Treasury regulations promulgated under section 199, but instead

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¹ Unless otherwise indicated, section references are to the Internal Revenue Code of 1986, as amended (the "Code") or the applicable regulations promulgated pursuant to the Code (the "regulations").

² Section 102, Pub. L. 108-357, 118 Stat. 1418 (2004), as amended by section 403(a) of the Gulf Opportunity Zone Act of 2005 (Pub. L. 109-135, 119 Stat. 25 (2005)), section 514 of the Tax Increase Prevention and Reconciliation Act of 2005 (Pub. L. 109-222, 120 Stat. 345 (2005)), section 401 of the Tax Relief and Health Care Act of 2006 (Pub. L. 109-432, 120 Stat. 2922 (2006)), section 401(a), Division B of the Energy Improvement and Extension Act of 2008 (Pub. L. 110-343, 122 Stat. 3765 (2008)), sections 312(a) and 502(c), Division C of the Tax Extenders and Alternative Minimum Tax Relief Act of 2008 (Pub. L. 110-343, 122 Stat. 3765 (2008)), section 746(a) of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (Pub. L. 111-312, 124 Stat. 3296 (2010)), section 318 of the American Taxpayer Relief Act of 2012 (Pub. L. 112-240, 126 Stat. 2313 (2013)), and sections 130 and 219(b) of the Tax Increase Prevention Act of 2014 (Pub. L. 113-295, 128 Stat. 4010 (2014)).

focuses on the specific questions that the IRS Office of Chief Counsel and the Large Business & International (“LB&I”) operating division have been called upon to answer when applying the statutory and regulatory language of the DPAD.

The following matrix is designed to facilitate the reader’s survey of the issues that have arisen most frequently under section 199, the paths that other taxpayers have pursued in seeking to obtain greater clarity, and the results of those efforts. The reader is left to reach his or her own conclusions as to the merits of the IRS’s determinations or of taxpayers’ positions in individual items. Similarly, broader observations suggested by this overall “body of work” representing the challenges presented in pursuing the intended tax incentive equitably and cost-effectively likewise are left to the reader.³

Item	Reg Cite/Topic	Determination	Industry
Cases			
<i>Gibson & Associates, Inc.</i> 136 T.C. 195 (2011)	1.199-3(m) construction	substantial erection or renovation of damaged roadways, bridges, <i>etc.</i> , was qualifying activity	construction
<i>ADVO, Inc.</i> 141 T.C. 298 (2013)	1.199-3(f) by the taxpayer	printer was entitled to the DPAD when it had benefits and burdens of ownership during printing of advertising mailers	printing
<i>Dean</i> 945 F. Supp. 2d 1110 (C.D. Cal. 2013)	1.199-3(e) MPGE	production of gift baskets is a qualifying activity	manufacturing
<i>Precision Dose, Inc.</i> 116 AFTR 2d (RIA) 6231 (N.D. Ill. 2015)	1.199-3(e) MPGE	production of single-dose medication capsules/vials is a qualifying activity	pharma

³ This compendium does not develop the detailed rules underlying the DPAD. Numerous other sources are available for a detailed review of these rules, including (among many other things) whether the taxpayer has received domestic production gross receipts (“DPGR”) from its manufacture, production, growing, or extraction (“MPGE”) of qualifying production property (“QPP”) in the United States, as well as how to determine the production costs incurred in generating the DPGR in order to derive the net income, or qualifying production activities income (“QPAI”), serving as one of the bases for the calculation of the DPAD. See Benko, 510-2d T.M., Section 199: Deduction Relating to Income Attributable to Domestic Production Activities.

Item	Reg Cite/Topic	Determination	Industry
IRS Guidance			
National Office			
<i>Revenue Rulings and Revenue Procedures</i>			
Rev. Proc. 2006-22, 2006-1 C.B. 1033	1.199-2 W-2 wage limitation	providing methods for calculating W-2 wages for purposes of computing the DPAD “wage limitation” for tax years beginning on or before May 17, 2006	various
Rev. Proc. 2006-42, 2006-2 C.B. 931	1.199-4; 1.861-8 section 861 method	procedures to obtain automatic approval to change certain elections relating to the apportionment of interest expense and of research and experimental expenditures in applying the “section 861 method”	various
Rev. Proc. 2006-47, 2006-2 C.B. 869	1.199-2(e)(1) W-2 wage limitation	providing methods of calculating W-2 wages and related rules for purposes of the wage limitation of section 199(b) for tax years beginning after May 17, 2006	various
Rev. Proc. 2007-34, 2007-1 C.B. 1345	1.199-5 passthroughs	conditions under which certain partnerships and S corporations may choose to calculate QPAI and W-2 wages at the entity level, as well as manner for allocating and reporting QPAI and W-2 wages to partners or shareholders.	passthroughs
Rev. Proc. 2007-35, 2007-1 C.B. 1349, modified by Rev. Proc. 2011-42, 2011-2 C.B. 318	procedural	guidance for determining when statistical sampling may be used for purposes of DPAD and acceptable statistical sampling methodologies	various
Rev. Rul. 2007-30, 2007-1 C.B. 1277	1.199-3(i)(7) qualifying disposition	designating entities engaged in extracting and processing minerals as “qualifying in-kind partnerships”	mining
Rev. Rul. 2011-24, 2011-2 C.B. 485	1.199-3(i)(6) qualifying disposition/telecom	whether telecom’s revenue is derived from a qualifying activity depends upon whether the tangible property is being used by the taxpayer in its provision of non-qualifying telecom service to the customer, or instead is provided to the customer for its own direct use	telecom

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IRS Guidance			
National Office			
<i>Other IRS National Office Guidance</i>			
PLR 200833014	normalization	it is not a violation of the Code normalization provisions to require use of the DPAD to calculate revenue requirements in the ratemaking process even if the DPAD is unavailable due to NOLs	public utilities
PLR 200838011 PLR 200843015 PLR 200843016 PLR 200942022 PLR 201043008 PLR 201048018 PLR 201050027 PLR 201049007 PLR 201046001 PLR 201138002 PLR 201138029 PLR 201152006	1.199-6 cooperatives	unless coop elects otherwise, section 199 is computed and applied at the coop level using all "net proceeds" payments or allocations; interim payments to coop patrons and patronage dividends are included in the coop's DPAD computation.	cooperatives
CCA 200806011	1.199-6 cooperatives	"per-unit retains paid in money" (PURPIMs) are deductible by marketing cooperative using pooling whether or not the product marketed for the farmers has been sold during the tax year; section 199 consequences unaffected by pooling	cooperatives
PLR 200946020	1.199-2; 1.199-6 W-2 wage limitation cooperatives	cooperatives are to compute the DPAD at the cooperative level, applying the W-2 wage limitation in the same manner applicable to expanded affiliated groups (i.e., compute W-2 wages separately for each member and apply the limitation at the cooperative level)	cooperatives
CCA 200946037	1.199-4(b)(2) cost allocation	all current-year cost of goods sold (COGS) must be included in determining QPAI for the year the costs are incurred, even if the costs relate to pre-199 revenue	various

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IRS Guidance			
National Office			
<i>Other IRS National Office Guidance</i>			
AM 2009-001	1.199-4(d); 1.861-8 section 861 method	describing allocation and apportionment under the section 861 method of prior-period compensation expense that is not included in COGS under section 263A (see CCA 200946037 and LMSB 04-0209-004)	various
AM 2009-009	1.199-1(c) QPAI	discussing interaction of QPAI and extraterritorial income (ETI) provisions	various
TAM 201049029	1.199-3(k) qualified film	DPGR includes gross receipts derived from licensing programming packages that include programs produced by taxpayer, programs produced by third parties, commercial advertisements, and interstitials	media
CCA 201014050	1.199-3(j) QPP	proceeds from sale of GMO products qualify as DPGR if the purchaser has no right to reproduce the item, but must be allocated between qualifying sale of QPP and non-qualifying license if purchaser acquires right to reproduce the GMO	manufacturing
CCA 201008043 (email)	1.199-6; 1.199-7 cooperatives EAGs	section 199 cannot be used to create a patronage NOL, unless the cooperative is a member of an expanded affiliated group	cooperatives
CCA 201139006 (email)	1.199-1 NOLs	discussing interaction of section 199 with one-time dividends-received deduction of section 965; section 199 cannot create or increase an NOL	various
PLR 201250009	1.199-6 cooperatives	coop will be treated as having MPGE the grain produced by and purchased from its members; coop's QPAI will be computed without regard to grain payments made to members and participating patrons	cooperatives

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IRS Guidance			
National Office			
<i>Other IRS National Office Guidance</i>			
CCA 201208029	1.199-3(m) construction	gross receipts from the sale of a natural gas well constructed by taxpayer qualify as DPGR, but receipts allocable to the sale of the associated lease are not qualified because are from the sale of an intangible	energy
CCA 201226025	1.199-3(i)(6) qualifying disposition / software	may not aggregate off-line third-party software to meet “third-party comparable” safe harbor, but can apply that safe harbor to individual components of taxpayer’s software (i.e., apply “shrink back” rule)	software
CCA 201246030	1.199-3(e)(2) MPGE	producing customized “blister packs” of medication for assisted living and similar facilities is “repackaging, labeling, or minor assembly,” and so is not a qualifying activity; manufacture of the packaging containing the medication is a qualifying activity (shrink back required)	pharma
TAM 201314043	1.199-3(f) by the taxpayer	property (including computer software) produced under government contract requiring transfer of ownership prior to completion may be a qualifying activity under safe harbor; transfer of IP pursuant to that contract is not a qualifying activity	government contractors
CCA 201313020	1.199-3(e) MPGE	producing electronic book or detailed print specifications for physical book are not qualifying activities; an activity can be “production” under section 263A but not “production” under section 199	publishing
CCA 201302017	1.199-3(m) and (n) construction /engineering	billboards affixed to wooden or steel poles are real property for purposes of DPAD	construction/ engineering

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IRS Guidance			
National Office			
<i>Other IRS National Office Guidance</i>			
TAM 201445010	1.199-3(i)(6) qualifying disposition / software	Taxpayer produced and licensed custom software to contracting party. Contracting party used the software to provide service to end users, with end users entering license agreements with both the taxpayer and the contracting party. Taxpayer was compensated based on fees derived by contracting party from end users. Taxpayer's gross receipts qualify as DPGR derived from the license of software to contracting party, rather than from services provided to end users. Taxpayer's license agreement with end users was to protect taxpayer's intellectual property.	software
PLR 201447027	1.199-2 W-2 wage limitation	computation of W-2 wage limitation for taxpayers using a 52-53 week tax year	various
CCA 201446018	1.199-4(d); 1.861-8 section 861 method	settlement payments and judgments for plaintiffs injured by taxpayer's products produced and sold prior to effective date of section 199 are not required to be allocated and apportioned to DPGR under the section 861 method	various
CCA 201446022	1.199-3(k) qualified film	DPGR does not include gross receipts derived from distribution by multichannel video programming distributor (e.g., local cable TV provider) of subscription packages produced by third-parties	media
AM 2014-001	1.199-3(e) MPGE	payments received by retailer from vendor as reimbursement for cooperative advertising costs generally included in retailer's DPGR; payor's intent in making payment determinative	retail

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IRS Guidance			
National Office			
<i>Other IRS National Office Guidance</i>			
AM 2014-008	1.199-3(i)(6) qualifying disposition / software	taxpayer derives no DPGR from disposition of software when customer downloads app free of charge if app only enables customer to access taxpayer’s on-line fee-based services.	software
CCA 201545018	1.199-3(k) qualified film	as regards the live broadcast of professional sporting events, the broadcaster rather than the team is engaged in the qualifying production activity for purposes of section 199	media
PLR 201601004	1.199-6 cooperatives	cooperative will be treated as having MPGE grain produced by and purchased from its members and then resold to a grain marketing LLC formed between coop, a neighboring coop, and a non-coop subchapter C corporation.	cooperatives
CCA 201603028 (email)	1.199-3(i)(6) qualifying disposition / software	“self-comparable” and “third-party comparable” exceptions for on-line software do not apply to revenue derived from software the taxpayer uses in providing a service to a customer rather than made available for the customer’s own direct use	software
CCA 201626024 (email)	1.199-3(i)(5) qualifying disposition / advertising	retailer’s distribution of catalogs does not produce DPGR when retailer MPGE’s the advertised products outside United States	retail
LB&I Guidance			
LMSB 04-1206-018 (2006)	procedural	initial guidance to LMSB examiners auditing a taxpayer’s section 199 deduction	various
LMSB 04-0707-049 (2007)	procedural	additional guidance to LMSB examiners auditing a taxpayer’s section 199 deduction	various

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IRS Guidance			
LB&I Guidance			
LMSB 04-0209-004 (2009)	1.199-4(d); 1.861-8 section 861 method	safe harbor for applying section 861 method to otherwise-deductible (non-COGS) prior-period compensation costs ("90-10 safe harbor")	various
LMSB 04-0310-010 (2010)	procedural	reclassifying section 199 to "Tier I – monitoring" status	various
LB&I-4-0112-001 (2012) (Benefits and Burdens I)	1.199-3(f)(1) by the taxpayer	three-step analysis for assigning benefits and burdens of ownership in contract manufacturing arrangements: contract terms (three factors), production activities (three factors), and economic risks (three factors)	various
LB&I-4-0713-006 (July 2013) (Benefits and Burdens II)	1.199-3(f)(1) by the taxpayer	replacing three-step analysis with benefits and burdens statement and certification statements signed by taxpayer and counterparty	various
LB&I-4-1013-008 (Oct 2013) (Benefits and Burdens III)	1.199-3(f)(1) by the taxpayer	removing financial accounting representation from benefits and burdens certification statement	various
FAA 20105101F	1.199-6 cooperatives	LMSB attorney memo "clarifying the teachings" of PLR 200942022 (above) to conclude that certain payments to cooperative patrons cannot be treated as PURPIMs or included in the coop's section 199 computation	cooperatives
FAA 20131802F	1.199-6 cooperatives	cooperatives must compute DPAD separately for patronage-sourced and non-patronage sourced income	cooperatives
FAA 20133302F	1.199-3(e) MPGE	retailer's in-store photo-processing is a qualified production activity; affixing photographs to DVDs or CDs not MPGE by taxpayer is not	retail
FAA 20150801F	1.199-6 cooperatives	conclusion of LB&I attorney that grain sale arrangements with LLC formed by multiple cooperatives did not satisfy requirements for PURPIMs, and so payments also could not be included in computing cooperatives' QPAI	cooperatives

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IRS Guidance			
LB&I Guidance			
CCA 20154021 (email)	1.199-3(i)(6) qualifying disposition / software	in emailed advice with limited information, concludes that taxpayer may not rely upon the third-party comparable exception for on-line software due to nature of either the taxpayer's software or industry	unknown
LB&I-04-0315-001 (2015)	1.199-3(e) MPGE	listing of activities (without explanation) that LB&I believes are not qualifying production activities: <ul style="list-style-type: none"> • cutting blank keys to customer specification • mixing base paint and a paint coloring agent • applying garnishments to cake that is not baked where sold • applying gas to agricultural products to slow or speed fruit ripening • storing agricultural products in a controlled environment to extend shelf life • maintaining plants and seedlings 	various

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