

Tax Alert

The “Manufacturers’ Deduction” isn’t Just for Manufacturers

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The Section 199 deduction is intended to encourage domestic manufacturing. In fact, it’s often referred to as the “manufacturers’ deduction.” But this potentially valuable tax break can be used by many other types of businesses besides manufacturing companies.

Section 199 Deduction 101

The Section 199 deduction, also called the “domestic production activities deduction,” is 9% of the lesser of qualified production activities income or taxable income. The deduction is also limited to 50% of W-2 wages paid by the taxpayer that are allocable to domestic production gross receipts.

Yes, the deduction is available to traditional manufacturers. But businesses engaged in activities such as construction, engineering, architecture, computer software production, and agricultural processing also may be eligible.

The deduction isn’t allowed in determining net self-employment earnings and generally can’t reduce net income below zero. But it can be used against the alternative minimum tax.

How Income is Calculated

To determine a company’s Section 199 deduction, its qualified production activities income must be calculated. This is the amount of domestic production gross receipts (DPGR) exceeding the cost of goods sold and other expenses allocable to that DPGR. Most companies will need to allocate receipts between those that qualify as DPGR and those that don’t — unless less than 5% of receipts aren’t attributable to DPGR.

DPGR can come from a number of activities, including the construction of real property in the United States, as well as engineering or architectural services performed stateside to construct real property. It also can result from the lease, rental, licensing, or sale of qualifying production property, such as:

- Tangible personal property (for example, machinery and office equipment),
- Computer software, and
- Master copies of sound recordings.

The property must have been manufactured, produced, grown, or extracted in whole or “significantly” within the United States. While each situation is assessed on its merits, the IRS has said that, if the labor and overhead incurred in the United States accounted for at least 20% of the total cost of goods sold, the activity typically qualifies.

Contact us to learn whether this potentially powerful deduction could reduce your business’s tax liability when you file your 2016 tax return.