THE RIGHT IDEAS.

THE RIGHT RESULTS.

ACHIEVED WITH THE RIGHT FIRM.

THE DOMESTIC PRODUCTION ACTIVITIES DEDUCTION: WHAT DOES IT MEAN FOR YOU?

BY GABE ADLER, CPA, PARTNER AND BRETT W. NEATE, CPA, MTAX, TAX MANAGER

ZINNER & CO. LLP
CERTIFIED PUBLIC ACCOUNTANTS
MANAGEMENT CONSULTANTS

29125 Chagrin Blvd.
Cleveland, OH 44122
email: info@zinnerco.com
p: 216.831.0733
f: 216.765.7118

www.zinnerco.com

THE DOMESTIC PRODUCTION ACTIVITIES DEDUCTION: WHAT DOES IT MEAN FOR YOU?

The Domestic Production Activities Deduction, or DPAD, is currently the second largest domestic corporate tax break available to taxpayers. It was enacted as part of the American Jobs Creation Act of 2004 to provide a deduction for U.S. businesses, and to offset the repeal of a tax break for U.S. exporters.

BY GABE ADLER, CPA, PARTNER AND BRETT W. NEATE, CPA, MTAX, TAX MANAGER

Many businesses, especially those in the manufacturing and construction sectors, should consider the benefits of the Domestic Production Activities Deduction (DPAD) under Internal Revenue Code Section 199.

While the rules are complex, DPAD provides a valuable tax break for qualified businesses and their owners. Since 2010, the benefit is fully phased in at 9% of income from qualified production activities.

At Zinner & Co. LLP we:

- Identify areas of potential qualified production activities
- Calculate domestic production gross receipts

- Allocate cost of goods that apply to domestic production gross receipts
- Allocate and apportion below-the line expenses if necessary
- Calculate the deduction

Who does the DPAD affect?

The DPAD is broad enough that roasting coffee, producing cuts of meat or fish for wholesale, software development, and making hamburgers qualifies for the deduction.

Unlike similar tax provisions in the past, the DPAD is also available to taxpayers who do not export. This includes sole proprietorships, both C and S corporations, partnerships, LLCs, cooperatives, estates, and trusts.

Additionally, beneficiaries of an estate or trust, as well as patrons of farming cooperatives, can be allocated a share of the DPAD for each entity.

Two-thirds of the businesses that are utilizing the DPAD are in the manufacturing sector, with the remaining third used by other industries such as computer software, logistics and distribution, utilities, construction and film production.

Engineering and architectural services performed in the U.S. may qualify for this deduction as well.

The DPAD is broad enough that roasting coffee, producing cuts of meat or fish for wholesale, software development, and making hamburgers qualifies for the deduction.

Although manufacturers benefit the most from the deduction on a nominal basis, the deduction is relatively more valuable to non-manufacturers:

Industry Grouping	Share of Deduction Claimed	Estimate of Qualifying Income as a Share of Taxable Income	Average Tax Rate After Section 199, but Before Credits
Manufacturing	65.1%	38.8%	34.31%
Information	12.7%	64.5%	34.59%
Mining	5.9%	29.1%	35.37%
Wholesale Trade	4.4%	19.0%	34.18%
Utilities	3.8%	53.8%	34.86%
Construction	3.5%	66.1%	31.85%
Professional and Technical Services	1.4%	20.3%	33.76%
Retail Trade	1.0%	4.2%	34.48%
Finance and Insurance	0.6%	1.0%	35.38%
Agriculture, Forestry, Fishing, and Hunting	0.5%	85.1%	28.62%
Management of Companies (Holding Companies)	0.5%	1.4%	34.97%
Accommodation and Food Services	0.3%	8.6%	34.37%
Real Estate and Rental and Leasing	0.1%	5.8%	33.40%
Administrative, Support, and Waste Services	0.1%	4.4%	34.03%
Other Services	0.1%	10.3%	29.89%
Transportation and Warehousing	< 0.1%	1.2%	34.58%
Arts, Entertainment, and Recreation	< 0.1%	6.7%	37.85%
Health Care and Social Assistance	< 0.1%	1.9%	33.89%
Educational Services	< 0.1%	6.0%	34.36%

Source: Shapiro, the Progressive Policy Institute, Center for Budget and Policy Priorities, Joint Committee on Taxation

Most activities eligible for the DPAD center around manufacturing, but many other businesses qualify as well. In fact, roughly one-third of all corporate activities qualify for the deduction.

What activities qualify as eligible for the DPAD?

Most activities eligible for the DPAD center around manufacturing, but many other businesses qualify as well. In fact, roughly one-third of all corporate activities qualify for the deduction.

Companies can even claim the break for products only partially produced in the U.S. According to a safe harbor in the regulations, if the manufacturing activities performed in the U.S. account for 20% of the costs, the companies may be eligible for the manufacturing deduction.

As former U.S. tax official John Harrington explained, “If you are in the Dow Jones industrial (average), and you are not taking this deduction there must be something wrong. It has always applied to a motley crew of activities.”

Some lines of business are specifically excluded from claiming the DPAD, including construction services that are cosmetic in nature (such as painting), leasing or licensing items to a related party, and selling food or beverages prepared at a retail establishment.

The categories of eligible activities include:

- Manufacturing based in the U.S. – manufacture, production, growth or extraction (MPGE) of tangible personal property, in whole or in significant part within the U.S.
- Selling, leasing, or licensing U.S- based manufactured items
- Selling, leasing, or licensing U.S.-produced motion pictures
- Domestic construction services – including residential building and renovation, as well as commercial real estate
- Professional services – including engineering and architecture related to U.S.-based construction projects
- U.S.-based software development – including video games
- Wholesale processing and preparation of food products not at the retail level
- Some lines of business are specifically excluded from claiming the DPAD, including construction services that are cosmetic in nature (such as painting), leasing or licensing items to a related party, and selling food or beverages prepared at a retail establishment.

Some lines of business are specifically excluded from claiming the DPAD, including construction services that are cosmetic in nature (such as painting), leasing or licensing items to a related party, and selling food or beverages prepared at a retail establishment.

What Does the Deduction Mean for You?

Simply put, the DPAD provides a valuable tax deduction for taxpayers whose business is involved in any of the aforementioned eligible activities. It replaced former foreign sales corporation and extraterritorial income provisions of the Internal Revenue Code (IRC), so taxpayers who did not benefit from those

The DPAD allows a deduction of 9% of the total net income from eligible activities, the economic equivalent to a 3% reduction in tax rate on eligible activities, per Section 199 of the IRC.

provisions' export tax benefits may currently be overlooking its value. The deduction is allowed for both regular tax and alternative minimum tax (AMT) purposes.

The DPAD allows a deduction of 9% of the total net income from eligible activities, the economic equivalent to a 3% reduction in tax rate on eligible activities, per Section 199 of the IRC. For example, a tax rate of 25% on a business for eligible activities in a given year would effectively become 22%. More businesses may find it worthwhile to calculate and substantiate the deduction than in previous years, when the percentage was at either 3% or 6%.

Keep in mind that the deduction for any year cannot exceed the taxpayer's taxable income (or for individuals, cannot exceed adjusted gross income). The DPAD is limited to 50% of the Form W-2 wages paid out to employees in the eligible activities. If a business is using independent contractors, it may be wise to determine if using more employees would achieve a larger overall tax savings due to this limitation.

The financial and operational leaders and advisors of Zinner & Co. provide practical solutions to the unique needs of manufacturers and distributors, as well clients in a myriad of other industries. Our extensive knowledge of accounting, tax, and financial analysis allows us to develop innovative and personalized solutions to help clients achieve their short- and long-term goals.

Contact the professionals at Zinner & Co. to determine if YOU qualify for the Domestic Production Activities Deduction and which steps you must then take to reap the benefits of this valuable tax break.

Contact the professionals at Zinner & Co. to determine if you qualify for the Domestic Production Activities Deduction and which steps you must then take to reap the benefits of this valuable tax break.

Want to determine if you qualify for the Domestic Production Activities Deduction?

Contact **Gabe Adler, CPA and Brett W. Neate, CPA, MTax** at Zinner & Co. LLP.

Reach Gabe Adler at 216.831.0733 or via email at gadler@zinnerco.com
Reach Brett W. Neate at 216.831.0733 or via email at bneate@zinnerco.com

Gabe Adler has 36 years of experience in the public accounting field. He merged his practice with Zinner & Co. in 1996. Gabe's client base includes owners of closely held businesses and professional service companies, whom he counsels in areas of accounting, tax, auditing, mergers and acquisitions, and how to transfer a business to the next generation. Gabe has a diverse clientele with a specialty in real estate. He advises many real estate owners, managers, and developers in developing their real estate tax strategies.

Brett Neate joined Zinner & Co. LLP in 2006. He was previously with a regional accounting firm, a bank-based financial services company, and a local wealth management company. Brett has successfully worked with high net worth individuals and multi-generational family owned businesses with tax planning, compliance, and audit resolution in the areas of federal, state, and local taxation. He has experience in many different industries including real estate, manufacturing, distribution, retail and professional service companies.