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DOMESTIC PRODUCTION ACTIVITIES DEDUCTION

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INTRODUCTION

The Domestic Production Activities Deduction, or DPAD, is one of the top ten domestic corporate tax breaks available to taxpayers. DPAD 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 breaks for U.S. exporters.

As tax advisors, we guide clients to ensure they understand the many tax breaks available and more important, how to position their company to receive those breaks. Our work with companies not only in the manufacturing sector, but across a multitude of industries, has helped to reduce taxes and mitigate risk. The DPAD is complex; we work closely with clients to:

- 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



WHY DPAD?

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 has been fully phased in at 9% of income from qualified production activities.

Who does the DPAD affect?

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

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.

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

Many businesses that are utilizing the DPAD are in the manufacturing sector, with the remaining in other industries such as computer software, logistics and distribution, utilities, construction and film production.



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

Extent to Which Different Industries Claim Domestic Production Deduction Against Corporate Income Tax

Industry Grouping	Total Number of Returns	Total Taxable Income (\$ millions)	Amount of Deduction Claimed (\$ millions)	Share of Deduction Claimed	Estimate of Qualifying Income as a Share of Taxable Income
Manufacturing	259,859	383,494	8,930	62.8%	38.8%
Information	116,514	63,265	2,447	17.2%	64.5%
Mining	38,348	24,126	421	3.0%	29.1%
Construction	742,436	9,786	388	2.7%	66.1%
Utilities	6,072	16,760	541	3.8%	53.8%
Wholesale Trade	375,922	51,992	594	4.2%	19.0%
Professional and Technical Services	864,803	26,077	318	2.2%	20.3%
Retail Trade	596,710	76,589	194	1.4%	4.2%
Finance and Insurance	239,864	132,294	81	0.6%	1.0%
Management of Companies	47,729	52,518	45	0.3%	1.4%
Agriculture, Forestry, Fishing and Hunting	138,792	2,237	114	0.8%	85.1%
Accommodation and Food Services	297,986	11,868	61	0.4%	8.6%
Real Estate and Rental and Leasing	647,037	6,355	22	0.2%	5.8%
Administrative, Support, and Waste Services	273,900	7,908	21	0.1%	4.4%
Other Services	375,059	1,891	12	0.1%	10.3%
Transportation and Warehousing	195,594	12,093	9	0.1%	1.2%
Arts, Entertainment, and Recreation	122,225	1,219	5	0.0%	6.7%
Health Care and Social Assistance	429,339	10,387	12	0.1%	1.9%
Educational Services	55,309	3,988	14	0.1%	6.0%
Other Industries (Not Allocable)	300	4	0	0.0%	0.0%
Total	5,824,545	894,850	14,228	100.0%	26.5%

*Figures are based on tax year 2009 data. The deduction was worth 6% of qualifying income in 2009. Had businesses been able to claim the full 9% in 2009, the amount of the deduction claimed would have been 50% higher.
Source: IRS Statistics of Income Data.

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.

Disqualified Production Activities

The following lines of business are specifically excluded from claiming the Domestic Production Activities Deduction:

- Construction services that are cosmetic in nature, such as painting
- Leasing or licensing items to a related party
- Selling food or beverages prepared at a retail establishment

Safe Harbor

The safe harbor is limited to activities in whole or significant part in the U.S. Under a safe harbor, a taxpayer is treated as having manufactured, produced, grown, or extracted property in significant part within the U.S. if direct labor and overhead costs incurred within the U.S. account for at least 20% of the total cost of the property.

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

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

More businesses may find it worthwhile to calculate and substantiate the deduction than in previous years, when the percentage was at either 3% (2005 & 2006) or 6% (2007-2009).

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.

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.

IN CLOSING

The accountants and advisors at Zinner & Co. provide practical solutions to the unique needs of manufacturers and distributors, as well as 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.



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ABOUT THE AUTHOR



Brett Neate joined Zinner & Co. in 2006 and was named partner of the firm in 2015. He 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.

Brett has experience in many different industries including real estate, manufacturing, distribution, retail, and professional service companies. In addition to tax services, he provides business advisory services to help his clients achieve their financial goals and remain prosperous.

Brett received his Bachelor of Arts in Business Administration with an accounting emphasis from Baldwin Wallace College and his Masters of Taxation from the University of Akron.

Memberships

The American Institute of Certified Public Accounts

The Ohio Society of Certified Public Accountants

Civic and Non-profit Organizations

WIRE-Net

The Muldoon Partners

The Emerging Leaders Academy - Upstream Academy Network

Source information

* <http://crfb.org/blogs/tax-break-down-section-199-domestic-production-activities-deduction>

Tax Law
Internal Revenue Code Section 199
American Jobs Creation Act of 2004
IRS.gov

A BIT ABOUT US...

In 1938, Harry Zinner had a vision for long term success. He founded a Cleveland-based bookkeeping firm that focused on integrity, commitment, and a pledge to help individuals, not-for-profit organizations and closely-held companies grow and prosper, not just for today, but for decades to follow.

Today, Zinner & Co. provides tax, accounting and management advisory services to guide businesses from startup to succession planning and help individuals create a solid financial foundation.

Our Beachwood, Ohio office is home to a dedicated team of CPAs and management advisors that provide a full slate of services beyond traditional tax and accounting. Contact us to discover how we can help you achieve your greatest financial potential.

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