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## **Memo: Domestic Production Deduction**

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Builders have available to them a little known deduction called the Domestic Manufacturing Deduction or called by its code section “The 199 Deduction”. The deduction is available to builders who have profits and payroll.

The 199 deduction is allowed to all taxpayers – individuals (shown on Form 1040 line 35), and C corporations (shown on Form 1120 line 25). The 199 deduction for partnerships and S corporations (reported on Form K-1 in box 13) flows through to the owner’s individual tax return.

The 199 deduction equals a percentage of the net income from eligible activities – 3% in 2005-2006, 6% for 2007-2009, 9% after 2009. However, the amount of the deduction for any tax year may not exceed the taxpayer's taxable income or, in the case of individuals, the taxpayer's adjusted gross income.

In addition, the amount of the 199 deduction can't exceed 50% of the "W-2 wages" (wages subject to income tax withholding, and certain deferred compensation) paid to employees for the year. This means that businesses operated as sole proprietorships or partnerships with no employees do not get the deduction. To take advantage of the deduction, such businesses could incorporate and pay W-2 wages.

As noted above, the 199 deduction equals a percentage of the net income from eligible activities. The deduction generally will apply to all contractors. The following is the definition as it applies to the construction industry:

**Construction.** Construction activities are eligible for the 199 deduction, but only if the construction is of real property performed in the U.S. The real property may consist of residential or commercial buildings, permanent structures (like docks and wharves), permanent land improvements (like swimming pools and parking lots), oil and gas wells, platforms, and pipelines, and infrastructure (like roads, sewers, sidewalks, and power lines). Real property doesn't include machinery unless it's a “structural component” – for an example, an elevator. Examples of businesses conducting eligible construction activities are residential remodelers, commercial and institutional building construction contractors, foundation, structure, and building exterior contractors, structural steel and precast concrete contractors, electrical, plumbing, heating, and air-conditioning contractors.

Eligible construction activities don't include tangential services such as hauling trash and debris, and delivering materials, even if the tangential services are essential for construction.

Construction includes "substantial renovation," but not decoration (or redecoration).

If you were eligible for this deduction and did not receive the deduction, you can generally amend your three previous year's tax return.

If you would like to discuss whether the 199 deduction would benefit you, and how to take advantage of it or determine if your CPA took this deduction, please do not hesitate to contact Weber O'Brien construction industry team members: R. David O'Brien, CPA at [dobrien@weberobrien.com](mailto:dobrien@weberobrien.com) or Barbara Hahn, CPA at [bhahn@weberobrien.com](mailto:bhahn@weberobrien.com).