**Tax Tips**

**The Code Section 199 Domestic Production Activities Deduction (Part 2 of 2)**

In this month’s Tax Tips, we’ll conclude our discussion of the Code Section 199 Domestic Production Activities Deduction.

**Eligible manufacturing and production activities.** A broad range of activities qualifies as eligible manufacturing or production activities. The taxpayer's raw materials and finished products may be brand new, or may be made out of scrap, salvage, or junk material. Manufacturing or producing components used by another party in later manufacturing or production activities are eligible activities, as are manufacturing or producing finished items from components manufactured or produced by others.

The processing and preparation of food products for sale at wholesale is an eligible “production” activity, but the preparation of food and beverages for sale at retail is not.

Generally, the taxpayer must own the property that it is “manufacturing or producing.” The manufacture or production of property under contract for someone else who owns the property isn't an eligible activity. (There are exceptions for some federal government contractors—and this requirement doesn't apply to construction, architecture, or engineering businesses.)

**Construction.** Construction activities are eligible for the Code Section 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).

**Engineering and architecture.** Engineering and architectural services are eligible for the Code Section 199 deduction, but only if they're performed in the U.S. for real property construction projects in the U.S. Eligible engineering services include consultation, investigation, evaluation, planning, design, and supervision of construction. Eligible architectural services include consultation, planning, aesthetic and structural design, and supervision of construction.

There's a lot more to the Code Section 199 deduction—for example, determining whether your particular business activities are eligible for the deduction, how to compute the net income from activities that are eligible, and how to determine the amount of the deduction when you've got income from both eligible and ineligible activities. The statutory rules are complicated, and IRS has issued voluminous—and equally complex—guidance on those rules.

 If you would like to discuss whether Code Section 199 applies to you, and, if so, how best to take advantage of it, please do not hesitate to call me at (562) 698-9891.

Richard Scrivanich, Partner

For Harvey & Parmelee LLP