AMERICAN JOBS CREATION ACT OF 2004

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The American Jobs Creation Act of 2004 introduced a deduction for qualified domestic production activities. While the deduction will ultimately reach 9% in 2010, it will only be 3% in 2005 and 2006, then 6% in 2007 through 2009. In short, the deduction is limited to 3% (in 2005) of the lesser of Qualified Production Activities Income or taxable income for the year. In the case of individuals, the deduction is equal to the applicable percent of the lesser of the taxpayer's (1) Qualified Production Activities Income for the taxable year, or (2) adjusted gross income (AGI) for the taxable year determined without regard to the deduction. The deduction is allowed for purposes of the AMT, except that the deduction is equal to the applicable percent of the lesser of the client's Qualified Production Activities Income, or AMTI. In the case of an individual, adjusted gross income is substituted for AMTI.

Practitioners have been eagerly awaiting guidance (well, OK, maybe not eagerly) in this complex area. It is important to understand that, while the deduction isn't available until 2005 tax returns, clients qualifying for the deduction must maintain appropriate records to support their calculation of the deduction. Recognizing this, the IRS issued Notice 2005-14, in late January providing interim guidance on the deduction until regulations can be issued.

The first question to answer is - which client qualifies for the deduction? The basic rule, with a couple of exceptions, is that the client that gets the deduction is the client bearing the benefits and burdens of ownership of the property while the qualifying activity occurs. For example, assume that Mary contracts with Pete to build a racecar for her to sell to Fred. While Pete is building the car, Mary bears the benefits and burdens of ownership – she owns the car. Mary is treated as the party qualifying for the deduction. Pete, on the other hand, is treated as providing a "service" to Mary. Since services don't qualify for the deduction, Pete gets no deduction for his work, even though he actually "constructed" the car.

Unfortunately, the guidance has several lengthy key terms that repeatedly must be referenced in discussing the deduction. These terms and the abbreviations used for them are as follows:

DPGR - Domestic Production Gross Receipts

EAG - Expanded Affiliated Group

MPGE – Manufactured, Produced, Grown or Extracted

QPAI - Qualified Production Activities Income

QPP - Qualified Production Property

The deduction is driven by the client's DPGR and is limited to 50% of the W-2 wages for the year. Thus, for those clients with large production activities, but little W-2 wages (because the work is subcontracted out), the benefits of the deduction may be less than anticipated. As one quickly sees, one of the keys to understanding the deduction is to understand what comprises DPGR.

DPGR is the client's gross receipts from a lease, rental, license, sale, exchange, or other disposition of QPP that was manufactured, produced, grown, or extracted in whole or in significant part within the United States. DPGR also consists of additional activities, including any qualified film produced by the client; electricity, natural gas, or potable water produced by the client in the United States; construction performed in the United States; and engineering or architectural services performed in the United States for construction projects in the United States. However, DPGR specifically excludes gross receipts derived from client prepared food and beverage sales (at a retail establishment) and the transmission or distribution of electricity, natural gas, or potable water. Also, business interruption insurance proceeds are DPGR, since they are generally substitutes for gross receipts that would qualify as DPGR. One significant trap is that gross receipts from a related party rental, lease or license are excluded. For purposes of this deduction, a related party is a commonly controlled business, whether incorporated or unincorporated, affiliated service group or employee leasing agreement and other, similar arrangements.

There are some also special rules that apply in certain situations.

- Advertising income is treated as DPGR for magazines and newspapers that include the advertising in their publications. Also, while service income doesn't qualify as DPGR, embedded services will not qualify (see below), except in the case of engineering and architectural services.
- Embedded services are those services that are included in the price of the product. For example, free assembly would be an embedded service and the revenue allocable to the "free assembly" wouldn't qualify as DPGR. There are two exceptions to this rule. First, gross receipts from a qualified warranty qualify as DPGR. A qualified warranty is a warranty provided with the sale of QPP if the charge for the warranty is included in the price charged for the transaction and the warranty is neither separately offered by the seller or lessor nor separately bargained for with the customer – in other words, the customer cannot purchase the QPP without the warranty. Second, a *de minimis* amount of gross receipts from embedded services for each item of property may qualify as DPGR. A *de minimis* amount of gross receipts from embedded services is defined as less than 5% of the gross receipts of the property. For purposes of applying this *de minimis* rule, the gross receipts from a qualified warranty that are included in the price charged for the lease, rental, license, sale, exchange, or other disposition of property are not treated as gross receipts for services. If one of these exceptions is met, the gross receipts of the sale, lease, etc. of the QPP and the embedded services are treated as DPGR.
- Computer software gross receipts do not include Internet access services, online services, customer support, telephone services, games played through a website, provider-controlled software online access services, and other services.
- Oil and gas partnerships can include the gross receipts from the sale of oil or gas or products as gross receipts arising from MPGE activities.
- DPGR from the construction of real property performed in the United States includes the proceeds from the sale, exchange, or other disposition of real property constructed by the client, (whether or not the property is sold immediately after construction is completed). DPGR also includes compensation for the performance of construction services by a client in the United States. However, DPGR derived from the construction of real property does not include gross receipts from the lease or rental of real property constructed by the client or gross receipts attributable to the sale or other disposition of land.

The term "construction" means the construction or erection of real property, including items that are structural components of buildings, inherently permanent structures other than tangible personal property in the nature of machinery, inherently permanent land improvements, and infrastructure. For purposes of the deduction, the term “infrastructure” includes roads, power lines, water systems, railroad spurs, communications facilities, sewers, sidewalks, cable, and wiring. The term also includes permanent oil and gas platforms.

The client must be in a trade or business that is considered construction for purposes of the North American Industry Classification System (NAICS codes). The NAICS construction codes are 23610-238990. Personal property (for example, appliances, furniture and fixtures) that is sold as part of real property (i.e. appliances in an apartment building) is not considered real property for this purpose. However, if more than 95 percent of the gross receipts from a construction project are from real property, then the total gross receipts derived by the taxpayer from the project are DPGR from construction.

As with the definition of tangible personal property, the fact that property is real property under local law is not controlling. On the other hand, property may be real property for purposes of the deduction even though under local law the property is considered tangible personal property.

Construction activities include those performed in connection with a project to construct or substantially renovate real property, but do not include services such as hauling trash and debris, and delivering materials, even if the services are essential for construction. However, if the client performing construction also, in connection with the construction project, provides tangential services such as delivering materials to the construction site and removing its construction debris, the gross receipts derived from the services are DPGR. Improving land by such activities as grading, landscaping and painting are construction activities only if these activities are performed in connection with other qualifying construction activities. However, the other qualifying activities can be either that of the client or of a third party. A client engaged in grading, landscaping and painting must make a reasonable inquiry to determine whether the activity relates to the construction or substantial renovation of real property.

Substantial renovation means the renovation of a major component or substantial structural part of real property that materially increases the value of the property, substantially prolongs the useful life of the property, or adapts the property to a new or different use.

DPGR includes gross receipts from engineering or architectural services performed in the United States for construction projects in the United States. Qualifying gross receipts include those from planned construction projects that are not completed or never get started, provided the client can prove the project was in the United States. Engineering services include any professional services requiring engineering education, training, and experience and the application of special knowledge of the mathematical, physical, or engineering sciences to those professional services such as consultation, investigation, evaluation, planning, design, or responsible supervision of construction for the purpose of assuring compliance with plans, specifications, and design.

Architectural services include the offering or furnishing of any professional services such as consultation, planning, aesthetic and structural design, drawings and specifications, or responsible supervision of construction (to ensure compliance with plans, specifications, and design) in connection with any construction project. Fortunately, there is a *de minimis* exception. If architectural or engineering services performed outside the United States or that relate to non-construction projects within the United States are less than 5% of the client’s gross receipts, they qualify as DPGR.

DPGR does not include gross receipts of the taxpayer that are derived from the sale of food or beverages prepared by the taxpayer at a retail establishment. A "retail establishment" is real property leased or used by the client for retail food and beverage sales, with a *de minimis* exception. A retail establishment will not be treated as a retail establishment if less than 5 percent of the food or beverages that are sold at that facility during the taxable year are retail sales. If a client's location is a retail establishment, then the guidance permits the client to allocate its gross receipts between gross receipts from the retail sale of the food and beverages prepared and sold at the retail establishment (which are non-DPGR) and gross receipts derived from the wholesale sale of the food and beverages prepared at the retail establishment (which are DPGR). The exception for sales of certain food and beverages also applies to food and beverages for non-human consumption.

Gross receipts is computed using the client's method of accounting (i.e. cash method). Gross receipts include total sales, net of returns and allowances, and all service income, investment income and any other income from incidental or outside sources. However, gross receipts doesn't include sales tax collected if the sales tax is imposed on the buyer and the client is merely collecting the tax and paying it over to the government. As a practical matter, income from interest, gains from the sale of property, dividends, annuities, and tax-exempt income will reduce the amount of the deduction because such income isn't DPGR. Further, in computing gross receipts, cost of sales isn't deducted. Additionally, there is no deduction for the basis of property sold if the property is inventory, property held for sale to customers in the ordinary course of business, depreciable property or real property used in the trade or business, a copyright, literary or musical composition, a letter, memorandum or similar property if prepared or created by the client, accounts and notes receivable acquired in the ordinary course of the client's business, or a U.S. government publication (including Notice 2005-14) received from the government. In short, the client can't reduce gross receipts by the basis of the property sold if the property isn't a capital asset under IRC Sec. 1221.

To qualify, the gross receipts must involve MPGE of QPP wholly or in a significant part arising out of a U.S. activity. For purposes of this deduction, the United States includes the 50 states (regardless of whether they were red or blue in the last election), the District of Columbia, U.S. territorial waters and the seabeds and subsoils of any waters adjacent to U.S. territorial waters that the U.S. has exclusive exploration and exploitation rights over. For many clients, this won't be an issue because their activity will all fall within the United States. However, for those clients with a mixture of U.S. and foreign activities, an allocation of the gross receipts will be critical.

Another fundamental issue is – what constitutes QPP? QPP is tangible personal property, computer software and sound recordings. Tangible personal property is any tangible property other than land, buildings - including items that are structural components of a building, qualified film produced by the client, electricity, natural gas or potable water produced by the client, computer software and sound recordings. However, the tangible medium on which a film, software or sound recording is contained, i.e. a videocassette or computer diskette, is tangible personal property. In determining whether property is "tangible personal property," the fact that property is personal property or tangible property under local law is not controlling. Conversely, property may be tangible personal property for purposes of this deduction even though under local law the property is considered a fixture and therefore real property. Property such as production machinery, printing presses, transportation and office equipment, refrigerators, grocery counters, testing equipment, display racks and shelves, and neon and other signs that is contained in or attached to a building is tangible property for purposes of the deduction. Further, property that is in the nature of machinery, other than structural components of a building, is tangible personal property even though located outside a building. Thus, for example, a gasoline pump, hydraulic car lift, or automatic vending machine would be considered tangible personal property. A structure that

is property in the nature of machinery or is essentially an item of machinery or equipment is not an inherently permanent structure and is tangible personal property. In the case, however, of a building or inherently permanent structure that includes property in the nature of machinery as a structural component, the property in the nature of machinery is real property. Still confused? It may be helpful to review the old investment credit rules, since those rules frequently dealt with these same concepts and can provide some valuable information on the distinctions between real property and tangible personal property.

MPGE qualifying activities include manufacturing, producing, growing, extracting, installing, developing, improving, and creating QPP. MPGE activities also include creating QPP out of scrap, salvage, or junk material as well as from new or raw material by processing, refining, or changing the form of an item, or by combining or assembling two or more items. Qualifying agricultural activities include cultivating soil, raising livestock, fishing, and mining minerals. MPGE activity also includes storage, handling or other processing activities, but not transportation activities, in the United States. However, the storage, handling and processing activities must be related to the sale, or other disposition of agricultural products, provided the products are used in connection with, or become part of other QPP whether or not by the client is involved in the process. Confused? An example may help.

Farmer Jack raises soybeans that he stores in Silos R Us (an unrelated entity) for a fee. Farmer Jack sells his soybeans to Tofu Tonight, Inc. (an unrelated entity) that uses the soybeans in its famous Turkey Tofu. Clearly, Farmer Jack and Tofu Tonight, Inc. meet the MPGE criteria. Thus, their gross receipts qualify as DPGR. Further, since Silos R Us is engaged in storing an agriculture product that is ultimately part of a qualifying MPGE, Silos R Us is also treated as a qualifying activity, so its gross receipts are also DPGR.

A client with MPGE QPP for the taxable year should also calculate the requisite IRC Sec. 263A adjustments. In other words, if a client wants the manufacturing deduction, he is going to be a producer, and thus subject to Sec. 263A, unless the client is exempted from Sec. 263A by regulations, published guidance, etc. If a client isn't properly applying Sec. 263A, and wants to change his method of accounting to comply with Sec. 263A, the client must follow the rules set forth in Rev. Proc. 97-27 or Rev. Proc. 2002-9, as appropriate. This is certainly one way to get those clients who thus far have ignored Sec. 263A to come clean, so to speak.

The next step is to then determine when a significant portion of the MPGE occurs in the United States. A common situation that will arise is one in which a client imports a partially manufactured item, and then finishes the process in the United States. To the extent that the client's actions, given all of the facts and circumstances, are substantial, the gross receipts from the activity will qualify as DPGR. On the other hand, if the client manufactures a product in the United States, then exports it, all of the gross receipts will be DPGR, regardless of whether the property is imported back into the United States for final disposition. However, packaging, repackaging, labeling, and minor assembly operations are not considered substantial. Sound vague and complex? It is, but fortunately, there is a safe harbor. A client will be treated as having MPGEs that constitute a significant portion to the extent the client's direct labor and factory burden costs account for at least 20% of the cost of sales of the QPP. In computing the costs to be used in the safe harbor calculation, development costs and any intangible costs for property other than computer software and sound recordings are not included. Also, just as under the general rule packaging, repackaging, labeling, and minor assembly operations are not included.

Getting the proper receipts classified as DPGR is only the first step. The next step is to allocate the appropriate costs against the DPGR in order to determine the QPAI. Generally, there are three sets of costs that must be deducted in arriving at QPAI.

First, the cost of sales directly allocable to the DPGR must be allocated. Cost of sales includes any costs allocated to inventory under IRC Sec. 263A, or under the general inventory valuation rules, including appropriate LIFO adjustments. Cost of sales also includes the basis of any non-inventory property if the sales proceeds are included in DPGR. How do you determine cost of sales? Well, if the cost of sales allocable to DPGR can be determined from the client's books and records, that is the amount that must be used. If the books and records are such that the cost of sales can't be determined, then any reasonable method may be used. However, if a client uses one method to allocate gross receipts, that same method must be used to allocate cost of sales.

Next, indirect costs directly allocable to DPGR must be deducted. Finally, a pro-rata share of deductions not directly allocable to DPGR or any other type of income must be deducted. The allocation of deductions is generally made under the same rules that govern the allocation of deductions between U.S. and foreign sourced income under IRC Sec. 861. This means that the allocation requires allocations under different methods for different expenses – a complicated and detailed series of calculations. Fortunately, there are some simplified methods for various small taxpayers. Qualification as a small taxpayer depends on average annual gross receipts. For purposes of computing this deduction, average annual gross receipts means the average annual gross receipts for the three tax years prior to the current tax year. If the client has been in existence less than three years, then the average is based on how long the client has been in existence. If one of the years is a short year, the gross receipts for that year must be annualized.

First, if average annual gross receipts are $25 million or less, the client may use the simplified deduction method. Under this simplified method, deductions are allocated pro-rata (based on gross receipts) between DPGR and non-DPGR. For an owner of an interest in a pass-through entity, the simplified deduction method is applied at the owner level, based upon the owner's DPGR and non-DPGR from all sources. This poses somewhat of a trap, however, since the owner's annual gross receipts is the determining factor. Thus, for example, an owner may have to use the non-simplified method, even though the entity's average annual gross receipts are under $25 million because his average annual gross receipts exceed $25 million.

If a client has average annual gross receipts of $5 million or less, or can use the cash method of accounting, the client qualifies for the small business simplified overall method. Thus, any client not prohibited from using the cash method of accounting should qualify for this exception. This would include any client with average annual gross receipts under $10 million that is not specifically prohibited from using the cash method of accounting under IRC Sec. 448, which would include individuals, most partnerships, S corporations and certain C corporations.

Under the small business simplified overall method, total cost of sales and all other deductions are allocated based on DPGR and non-DPGR gross receipts. Clearly, this method significantly reduces the complexity of the calculations. However, as with any simplified method, the net results are not necessarily as accurate as allocations under the regular method would be. Of course, this issue is offset by the reduced costs of calculating the appropriate deduction.

There are a couple of special situations that must be considered. First, members of an EAG can use the simplified deduction method if the average annual gross receipts of the EAG meet the annual limitations. Thus, the EAG, as a whole, will qualify or not qualify for the simplified methods. For purposes of determining the annual computation, the client must use the gross receipts of any member's taxable year ending with or within the client's yearend. It makes no difference whether the EAG member was a member for the full year. Further, an EAG member qualifying to use the method can do so only if all of

the other EAG members agree to and use the same method. If members of an EAG have different taxable years, in determining the client's deduction, the client is required to take into account the taxable income or loss, QPAI, and W-2 wages that are both (1) attributable to the period during which the member of the EAG and the client are both members of the EAG and (2) taken into account in a taxable year that begins after the effective date of and ends with or within the taxable year of the client with respect to which the deduction is computed.

As noted earlier, the deduction is computed at the partner or shareholder level. Thus, each partner or shareholder computes the deduction separately from every other partner or shareholder. QPAI generally does not include gain or loss recognized on the sale, exchange, or other disposition of an interest in the entity. However, if IRC Sec. 751 (a) or (b) applies, gain or loss allocable to assets of the partnership the sale, exchange, or other disposition of which would give rise to QPAI is taken into account in computing the partner's deduction.

In computing the deduction, each partner and shareholder must aggregate his or her share of entity qualified production activities with any expenses the partner incurs directly that are allocated to the entity's qualified production activities as well as other qualified production activities. A partnership may make special allocations of qualified production income, expenses and deductions, subject to the general substantial economic effect rules.

In addition, partners must take into account his or her own share of partnership expenses allocated to the entity's qualified production activities, regardless of whether the partnership has taxable income. However, if any deduction would be disallowed by the at risk rules, passive loss rules or any other, similar tax rules, then those items cannot be deducted in arriving at the manufacturing deduction. If only some of the deductions are limited by these rules, then a proportionate share of the deductions can be used to determine the manufacturing deduction. When the disallowed expenses are subsequently allowed, they will then be allowed for purposes of computing the manufacturing deduction in the subsequent year.

For pass-through entities, the deduction will not apply to years beginning before January 1, 2005.

After making all of the computations, there is still another limitation to consider. The deduction is limited to 50% of "W-2" wages paid by the client. This is a deceptive limitation, because W-2 wages are not simply the amount in Box 1. Instead, W-2 wages include the total amount of wages as defined in IRC Sec. 3401(a) (box 1 of the 2004 W-2 plus the total amount of Sec. 457 compensation deferred and, for tax years beginning after December 31, 2005, the amount of designated Roth contributions). Fortunately, in the 2004 W-2s, the elective deferrals and the deferred compensation amounts directly correlate to coded items reported in Box 12 on Form W-2. Box 12, Code D is for elective deferrals to a cash or deferred arrangement under IRC Sec. 401(k); Box 12, Code E is for elective deferrals under an IRC Sec. 403(b) salary reduction agreement; Box 12, Code F is for elective deferrals under a salary reduction Simplified Employee Pension (SEP); Box 12, Code G is for elective deferrals under an IRC Sec. 457(b) plan; and Box 12, Code S is for employee salary reduction contributions under a SIMPLE (simple retirement account).

Clients have a choice of three methods in computing the appropriate W-2 wages:

Unmodified Box Method – W-2 wages are the wages computed by taking the lesser of Box 1 or Box 5 (Medicare wages).

Modified Box 1 Method – Under this method, start with the total of Box 1 wages, then subtract any amounts in Box 1 that aren't wages for income tax withholding purposes and amounts included in Box 1 of Forms W-2 that are treated as wages under IRC Sec. 3402(o), such as supplemental unemployment compensation benefits. Then add to this amounts reported in Box 12 of Form W-2 that are properly coded D, E, F, G, or S.

Tracking Wages Method – This is the most complex method, since it requires the client to actually track total wages subject to federal income tax withholding and then make appropriate modifications. W-2 wages under this method are calculated as follows:

1. Start with wages subject to federal income tax withholding that are reported on Forms W-2 for the calendar year;
2. Subtract supplemental unemployment compensation benefits included in wages;
3. Add amounts in Box 12 of the W-2s properly coded as D, E, F, G or S.

The IRS was concerned about the ability of clients to use affiliated groups to avoid the limitations imposed on this deduction. Accordingly, the IRS is using an EAG to determine the various limitations. An EAG is treated as a single corporation for purposes of computing the deduction.

The starting point for the definition of an EAG is Sec. 1504(a), which defines an affiliated group. Generally, an affiliated group is one or more chains of corporations connected through stock ownership with a common parent. However, to be an affiliated group, two tests must be met. First, the common parent must own at least 80% of the total voting power of at least one of the other corporations. In addition, the common parent's ownership must have a value of at least 80% of the total value of the other corporation's stock. Second, the stock meeting the 80% test in each member of the affiliated group (other than the common parent) must be owned directly by another member of the group. Then, for purposes of the manufacturing deduction the definition is "expanded" by replacing the 80% test, wherever it is mentioned, with a 50% test. Thus, to the extent that there is 50% ownership of a group of corporations, the client has an EAG, and the entities are all treated as one taxpayer for purposes of the deduction.

This requires the aggregation of each member's taxable income or loss, QPAI and W-2 wages. A complexity for an EAG is the required removal of any gross receipts from related entities. Thus, computing DPGR for an EAG could be a very complicated and time-consuming process. One benefit, however, that arises from having an EAG, is that the activities of one member are attributed to another member. For example, if one member manufactures QPP in the United States, selling it to another member who in turn sells it to an unrelated party, both members' manufacturing costs are counted in the computation of the deduction, and (assuming all the other tests are met) the gross receipts from the sale to the third party qualifies as DPGR. Of course, there is an anti-abuse rule that prohibits structuring a transaction to take advantage of the EAG rules.

Membership in an EAG is determined on a daily basis. Thus, the EAG member's QPAI and W-2 wages must be allocated between the portion of the taxable year the member was part of the EAG and the portion of the year the member was outside the EAG. While the allocation is generally made pro-rata on a daily basis, the corporation may elect to use the closing of the books method. Under the closing of the books method, the taxable income, QPAI and W-2 wages are computed by treating the corporation as though it had two separate years, one ending at the close of the day on which the corporation's status as an EAG member changes, and the second one ending on the corporation's normal tax year-end.

If a corporation is a member of an EAG for part of the year, the corporation's manufacturing deduction is the sum of the deduction computed for the part of the year the corporation wasn't a member of the EAG plus the corporation's allocated manufacturing deduction from the EAG.

One final issue in computing the EAG Sec. 199 deduction involves the rules that apply when members of an EAG have different tax year-ends. n that case, the member must consider the taxable income, QPAI and W-2 wages that are both attributable to the period the members of the EAG and the member computing the deduction were both members of the EAG, and the taxable income, QPAI and W-2 wages are taken into account in a tax year beginning after 1-1-05 and ending with or within the tax year of the computing member.

Once the EAG's deduction is computed for the entire group, it is allocated among members based on each member's QPAI, regardless of whether the member has net income or W-2 wages. If a member has negative QPAI, the QPAI is zero.

Things become more complicated if an EAG includes members of a consolidated group. A consolidated group is one required to or electing to file a consolidated return for the year. If an EAG includes a consolidated group, the consolidated group's taxable income, not the income of the individual consolidated group members is used for purposes of computing the deduction. As with a regular member of an EAG, the manufacturing deduction allocated to a consolidated group member must be based on the member's proportionate share of consolidated group QPAI. If a member has negative QPAI, the QPAI is zero.

As one quickly sees, the new deduction is a very complex deduction, even considering the IRS's attempts to offer simplified calculations. Should a simplified method be used in every case? This is a tough question, because history had repeatedly demonstrated that a simplified method often produces less benefit. On the other hand, the costs and time required to maintain the records to provide a precise allocation don't seem to be warranted by the additional savings, particularly for small clients. Thus, using the simplified method seems to be the most reasonable and cost effective approach in most cases. However, this is an area where professional judgment should be exercised and the client should be aware of the options and the cost/benefits of those options.

In summary, then, the steps to compute the deduction are:

1. Allocate gross receipts between DPGR and non-DPGR sources.
2. Deduct allocated cost of sales and indirect costs from DPGR.
3. Deduct a pro-rata share of other expenses from DPGR, using either the method provided under Sec. 861 or one of the simplified methods.
4. Compare the results obtained from the first three steps to taxable income – then select the lower amount.

5. Multiply the result in step 4 by 3%.
6. Compare the amount in step 5 with 50% of W-2 wages and select the lower amount.
7. Congratulations, you've just successfully computed the new Sec. 199 deduction. Be sure to send your client a bill for the extra time this new tax benefit has required.

Now is the time to begin working with clients on this deduction. Next tax season will be too late and may limit your opportunities to take maximum advantage of this tax break.