Congress of the United States
JOINT COMMITTEE ON TAXATION
Washington, DC 20515–6453

SEP 22 2004

**MEMORANDUM**

**TO:** Mark Prater and Patrick Heck

**FROM:** George K. Yin

**SUBJECT:** Revenue Estimate Request

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This is in response to your request for information on the effects of certain provisions contained in H.R. 4520, as amended by the Senate.

We provide below the requested information for fiscal year 2005 and, in one case, fiscal year 2014, relating to section 102 (deduction relating to income attributable to U.S. production activities) of H.R. 4520, as amended by the Senate. The information concerning revenue loss takes into account sections 102 and 103 of H.R. 4520 (section 103 extends the tax benefit provided in section 102 to certain architectural and engineering services).

Part of your request requires the division of taxpayers into manufacturers and non-manufacturers. The activity classifications used below, including manufacturing and other categorizations, generally are provided voluntarily by the taxpayer and relate to the taxpayer's primary activity. Because of consolidation and other issues, some taxpayers identifying themselves as manufacturers will participate in non-manufacturing activity and vice versa. In addition, the manufacturing deduction contained in H.R. 4520, as amended by the Senate, explicitly excludes income from some activities, such as petroleum production, that are classified by the Internal Revenue Service ("IRS") as manufacturing, while including some income from activities, such as the production of computer software, that are classified by the IRS as non-manufacturing. Data provided on activity classification should be considered with these caveats in mind.

We project that about 2.2 million subchapter C corporations will file Form 1120 tax returns in fiscal year 2005, and 200,000 subchapter C corporations will file Form 1120A tax returns. We estimate that about 300,000 of these 2.4 million returns will be inactive. About 135,000 subchapter C corporations will identify their primary activity as manufacturing, and about 9,000 of those firms will be inactive. Almost all active firms that identify themselves as manufacturers, that is, about 126,000 firms, will also have positive "domestic production gross receipts" as defined in H.R. 4520 as amended by the Senate. About 54,000 of these 126,000 manufacturing firms with gross receipts will have "modified taxable income attributable to domestic production activities" as defined in H.R. 4520, as amended by the Senate. Of the 54,000 manufacturing corporations with gross receipts and modified taxable income attributable to domestic production activity, more than 45,000 will receive some tax benefit from the manufacturing deduction. For most companies that will receive no tax benefit, complete benefit denial is attributable to an overall loss position or the wage limitation, with the foreign activity limitation playing almost no role in causing companies to get no tax benefit from the manufacturing deduction.

You requested stylized information about the minimum amount of modified taxable income from domestic production activities that a subchapter C corporation would need in order to generate a tax benefit of $50,000 in, respectively, fiscal years 2005 and 2014. The deduction percentages provided for in H.R. 4520, as amended by the Senate, are five and nine percent, respectively, for fiscal years 2005 and 2014. Assuming that the corporation has no foreign activity and is not subject to the wage limitation or in an overall loss situation, the corporation would need at least $2.9 million of modified taxable income from domestic production activities in order to receive a $50,000 tax benefit from the manufacturing deduction in fiscal year 2005, while the equivalent amount in fiscal year 2014 would be $1.6 million of modified taxable income. We estimate that, in fiscal year 2005, less than 5,000 companies will receive a tax benefit of $50,000 or greater.

We also estimate that, in fiscal year 2005, approximately two-thirds of all returns with positive modified taxable income attributable to domestic production activities will not be subchapter C corporations. We project that entities that will pass through a tax benefit under section 102 of H.R. 4520, as amended by the Senate, will include about 85,000 S corporations, about 15,000 partnerships, and about 50,000 sole proprietorships. We do not have a detailed projection of the number of individuals who would receive a direct or indirect benefit from section 102 of H.R. 4520, as amended by the Senate.

With respect to the estimated revenue loss for the manufacturing deduction for fiscal year 2005, 75 percent is associated with subchapter C corporations, 12 percent is associated with cooperatives and S corporations, nine percent with partnerships, and four percent with sole proprietorships.