



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Large and Mid-Size
Business Division

LMSB-Control Number: LMSB-04-0707-049
Impacted IRM 4.51.2

August 24, 2007

MEMORANDUM FOR LMSB INDUSTRY DIRECTORS
DIRECTOR, PRE FILING AND TECHNICAL GUIDANCE
DIRECTOR, FIELD SPECIALISTS
DIRECTOR, INTERNATIONAL COMPLIANCE
LMSB AREA COUNSEL

FROM: John Risacher, /s/John Risacher
Acting Industry Director, Heavy Manufacturing and Transportation

SUBJECT: Tier 1 – Domestic Production Deduction
[REDACTED]

This directive is a follow-up on the Industry Directive issued December 6, 2006, Tier I – Industry Director Directive on Domestic Production Deduction (DPD). As a Tier I issue, IRM 4.51.1 the Rules of Engagements describes responsibilities of the Executive Issue Owner. “The Executive is responsible for ensuring that the issue is identified, developed and resolved in a consistent manner across all LMSB cases involving similarly situated taxpayers. The disposition or resolution of the issue must be in accordance with that Executive’s guidance.” The intent of this directive is to describe controls being placed on the larger deduction amounts to comply with the consistent development and resolution of these cases.

Background

Section 199, the Domestic Production Deduction, is a provision enacted in the American Jobs Creations Act of 2004 that generally allows taxpayers to receive a deduction based on qualified production activity income resulting from domestic production. This issue has been designated as a Tier I issue. The revenue impact of this provision is anticipated to be \$76 billion over the first ten years of its life.

In the initial years, the deduction is 3% for the 2005 and 2006 years, moving to 6% for 2007 through 2009 and then 9% for all years thereafter. Qualifying domestic production includes the manufacture of tangible personal property; the production of computer software, sound recordings and certain films; the production of electricity, natural gas, water; construction, engineering, and architectural services.

Classification as a Tier 1 issue

The domestic production deduction (DPD) is a Tier 1 issue due to our desire to be proactive in a significant new area of tax law. There are significant tax dollars involved, the law is complex with many nuances and initial indications are inconsistencies in applications exist. As we audit this issue, compliance risks are emerging which stem from these factors and which we will be better prepared to address in a consistent fashion as a Tier 1 issue.

Issue Tracking

See attachment

Criteria and Audit Selection

The prior Industry Directive on DPD ([Industry Director Directive on Domestic Production Deduction](#)) provides minimum checks that are required on every case and can aid in determining whether or not to include the issue in an audit plan. In order to avoid inappropriate delays and constrains on the field not all cases with the DPD are mandatory examinations. However, cases meeting established criteria that are being sent to the field are mandatory examinations.

There is the potential to spend substantial audit resources in an examination due to the complexity of the law. Our intent is to assist in determining the most effective ways and appropriate areas in which the team should focus. Coordination is also required to bring consistency needed with this significant issue on cases with a domestic production deduction.

Our belief is that almost all of these cases are being examined as current IC and CIC workload.

Roles and responsibilities aligned with the rules of engagement

The following requirements will be put in place for returns with the Domestic Production Deduction (DPD)

1. The team manager assigned to the case will contact the DPD Technical Advisors to share and discuss the audit plan with regard to the DPD. Other data that may be of assistance in this process are a description of the company and the Form 8903, Domestic Production Deduction.
2. Contact will be maintained with the DPD Technical Advisors during the audit process to discuss issues and involve them as needed throughout this process.
3. All Forms 5701, Notice of Proposed Adjustment, Form 886A and/or Form 906, Closing Agreement, will be provided to the DPD Technical Advisors for review and concurrence.

4. Similarly with Fast Track, Pre-Appeals conferences or Pre-Filing Agreement cases, the team manager will contact the DPD Technical Advisors for their involvement in the process including attending any Fast Track conferences and concurrence with any agreement to either process.

The Technical Advisor Team has indicated that they will put in place a ten workday turnaround on the review of Forms 5701, Form 886A and/or Form 906. [REDACTED]

Internal communications

[REDACTED]

The technical advisor team is ready to assist teams in examining this issue and answering questions via [REDACTED] personal contacts. In addition, each of the industry technical advisors also has experience with their industry unique DPD rules and is also available. I encourage interaction with them and our DPD technical advisors on all cases. [REDACTED]

This LMSB Directive is not an official pronouncement of law or the position of the Service and cannot be used, cited or relied upon as such. It is for internal use only.

Attachment to Industry Directive LMSB-04-0707-049

Issue Tracking:

UIL Codes:

199.00-00 – Income attributable to Domestic Production Deduction Activities.

199.01-00 - Taxable Income and Adjusted Gross Income.

199.01-01 - Taxable income and adjusted gross income.

199.02-00 - Wage limitation.

199.03-00 - Domestic Production Gross Receipts (DPGR).

- 199.03-01 - Definition of manufactured, produced, grown, or extracted.
- 199.03-02 - Definition of by the taxpayer.
- 199.03-03 - Definition of in whole or in significant part.
- 199.03-04 - Definition of United States.
- 199.03-05 - Derived from the lease, rental, license, sale, exchange, or other disposition.
- 199.03-06 - Allocation of gross receipts.

199.04-00 - Costs allocable to Domestic Production Gross Receipts.

- 199.04-01 - Cost of goods sold allocable to Domestic Production Gross Receipts.
- 199.04-02 - Other deductions properly allocable to Domestic Production Gross Receipts or gross income attributable to Domestic Production Gross Receipts.

199.05-00 - Application of section 199 to pass-thru entities for taxable years beginning after May 17, 2006, the enactment date of the Tax Increase Prevention and Reconciliation Act of 2005 [reserved].

199.06-00 - Agricultural and horticultural cooperatives.

199.07-00 - Expanded affiliated groups.

199.08-00 - Other rules.

SAIN Code:

527 – Domestic Production Activities (for years 2005 and later).