



Instructions for Form 8903

Domestic Production Activities Deduction

Section references are to the Internal Revenue Code unless otherwise noted.

What's New

Final regulations. Final regulations under section 199 were issued on June 1, 2006. See *Additional Guidance*, on this page.

Form W-2 wages. For tax years beginning after May 17, 2006:

- The limit equal to 50% of Form W-2 wages is no longer based on Form W-2 wages from all businesses. Only wages properly allocable to domestic production gross receipts are included.
- The rules for determining Form W-2 wages of partners and S corporation shareholders are simplified by determining Form W-2 wages without regard to any limit based on qualified production activities income.

See *Form W-2 Wages*, on page 5.

Simplified deduction method.

Under the final regulations, you may be able to use the simplified deduction method if your average annual gross receipts are \$100 million (up from \$25 million) or less. See *Simplified Deduction Method* on page 4.

Activities in Puerto Rico. For tax years beginning after December 31, 2005, certain taxpayers can take the domestic production activities deduction for activities in Puerto Rico. A special rule applies when figuring Form W-2 wages. See section 199(d)(8) for details.

General Instructions

Purpose of Form

Use Form 8903 to figure your domestic production activities deduction (DPAD).

Your DPAD is generally 3% of the smaller of:

1. Your qualified production activities income (QPAI), or
2. Your adjusted gross income for an individual, estate, or trust (taxable

income for all other taxpayers) figured without the DPAD.

However, your DPAD generally cannot be more than 50% of the Form W-2 wages you paid to your employees (including Form W-2 wages allocated to you on a Schedule K-1).

Additional Guidance

These instructions cover DPAD rules from Internal Revenue Code section 199. They also cover a few rules addressing common situations from additional guidance. For more information on the DPAD rules, generally see Regulations sections 1.199-1 through 1.199-9. However, for tax years beginning before June 1, 2006, you can choose not to rely on any part of the final regulations and rely instead on guidance provided in 2005 by Notice 2005-14 and Proposed Regulations sections 1.199-1 through 1.199-8. But, for tax years beginning after May 17, 2006, you must figure Form W-2 wages with the changes discussed above under *Form W-2 Wages*.

For guidance on figuring Form W-2 wages, see *Form W-2 Wages* on page 5.

For guidance on computer software provided to customers over the Internet, see Treasury Decision (T.D.) 9262 and Announcement 2006-56.

You can find the final regulations in T.D. 9263 on page 1063 of Internal Revenue Bulletin (I.R.B.) 2006-25 at www.irs.gov/pub/irs-irbs/irb06-25.pdf. You can find Notice 2005-14 on page 498 of I.R.B. 2005-7 at www.irs.gov/pub/irs-irbs/irb05-07.pdf. You can find the proposed regulations on page 987 of I.R.B. 2005-47 at www.irs.gov/pub/irs-irbs/irb05-47.pdf. You can find T.D. 9262 on page 1040 of I.R.B. 2006-24 at www.irs.gov/pub/irs-irbs/irb06-24.pdf. You can find Announcement 2006-56 on page 342 of I.R.B. 2006-35 at www.irs.gov/pub/irs-irbs/irb06-35.pdf.

Who Must File

Individuals, corporations, cooperatives, estates, and trusts use Form 8903 to figure their allowable DPAD from certain trade or business activities. Shareholders of S corporations and partners use information provided by the S corporation or partnership to figure their allowable DPAD. Beneficiaries of an estate or trust use information provided by the estate or trust to figure their allowable DPAD. Patrons of certain agricultural or horticultural cooperatives may be allocated a share of the cooperative's DPAD.

However, unless you were allocated a share of a cooperative's DPAD or you are a member of an expanded affiliated group (EAG), you will not be allowed a DPAD unless you can enter on Form 8903 a positive amount for all three of the following.

- Qualified production activities income (QPAI).
- Adjusted gross income for an individual, estate, or trust (taxable income for all other taxpayers).
- Form W-2 wages you paid to your employees. If you did not pay any Form W-2 wages (or have Form W-2 wages allocated to you on a Schedule K-1), you cannot claim a DPAD.

For details, see the discussions of these three items that begin on page 2.

Married individuals filing a joint income tax return figure the deduction on one Form 8903 using the applicable items of both spouses.

Definitions and Special Rules

Trade or business. QPAI and Form W-2 wages are figured by only taking into account items that are attributable to the actual conduct of a trade or business. An activity qualifies as a trade or business if your primary purpose for engaging in the activity is for income or profit and you are involved in the activity with continuity and regularity. For example, a

sporadic activity or a hobby does not qualify as a trade or business.

Coordination with other deductions. Expenses that otherwise would be taken into account for purposes of figuring the DPAD are only taken into account if and to the extent the losses and deductions from all of your activities are not disallowed by any of the following provisions.

- Basis limits on a partner's share of partnership losses.
- Basis limits on a shareholder's share of S corporation losses.
- At-risk rules.
- Passive activity rules.
- Any other provision of the Internal Revenue Code.

If only a portion of your losses or deductions are allowed in the current tax year, a proportionate share of the losses or deductions that reflect expenses allocated to your gross receipts from qualified production activities, after applying the provisions listed above, is taken into account for purposes of figuring the DPAD for the current tax year. If any of the losses or deductions disallowed for tax years beginning after 2004 are allowed in a later tax year, a proportionate share of the expenses reflected in those losses or deductions is taken into account in figuring the DPAD in the later tax year.

S corporations and partnerships.

The DPAD is applied at the shareholder or partner level. S corporations and partnerships need to provide each shareholder or partner with information the shareholder or partner needs to figure the DPAD.

Estates and trusts. Generally, an estate or trust will figure its:

- QPAI (which may be less than zero), and
- Form W-2 wages it paid to its employees (including Form W-2 wages allocated to it on a Schedule K-1).

These items are then allocated among the estate or trust and its beneficiaries based on the relative proportion of the estate's or trust's distributable net income (DNI) for the tax year that is distributed or required to be distributed to the beneficiary or retained by the estate or trust. If the estate or trust has no DNI for the tax year, QPAI and Form W-2 wages are allocated entirely to the estate or trust.

Although estates and trusts actually allocate their QPAI and Form W-2 wages to beneficiaries as

discussed above, when completing Form 8903 they must reduce the amounts reported on certain lines to reflect the portion of those amounts that were allocated to beneficiaries as QPAI or Form W-2 wages. For details, see *Specific Instructions* on page 6.

Agricultural and horticultural cooperatives.

Generally, an agricultural or horticultural cooperative can choose to allocate all, some, or none of its allowable DPAD to its patrons. For this purpose, an agricultural or horticultural cooperative is an organization described in section 1381 that is engaged in the:

- Manufacturing, production, growth, or extraction in whole or significant part of any agricultural or horticultural product, or
- Marketing of agricultural or horticultural products.

An organization engaged in marketing agricultural or horticultural products is treated as having manufactured, produced, grown, or extracted in whole or significant part any qualifying production property marketed by the organization that its patrons have so manufactured, produced, grown, or extracted. For this purpose, agricultural or horticultural products include fertilizer, diesel fuel, and other supplies used in agricultural or horticultural production.

Allocation of cooperative DPAD.

A patron who receives a patronage dividend or qualified per-unit retain certificate can be allocated any portion of the DPAD allowed with respect to the portion of the QPAI to which such payment is attributable. The cooperative must identify the portion of its DPAD allocated to a patron in a written notice mailed to the patron no later than the 15th day of the 9th month following the close of the cooperative's tax year. The allocated DPAD will also be reported to patrons that are not corporations on Form 1099-PATR, Taxable Distributions Received From Cooperatives.

Expanded affiliated groups (EAGs).

All members of an EAG are treated as a single corporation to figure their DPAD. The DPAD is allocated among the members of the group in proportion to each member's respective amount (if any) of QPAI. See the instructions for line 18 before completing Form 8903.

An EAG is an affiliated group as defined in section 1504(a) determined:

- By substituting "more than 50 percent" for "at least 80 percent" each place it appears, and
- Without regard to paragraphs (2) and (4) of section 1504(b).

A corporation's status as a member of an EAG is determined on a daily basis. Also, if a corporation joins or leaves an EAG, its status as a member of the EAG is determined at the end of the day on which it joins or leaves the EAG.

If all the capital and profits interests of a partnership are owned by members of a single EAG at all times during the partnership's tax year, the partnership and all members of the group are treated as a single taxpayer to figure their domestic production gross receipts (DPGR) for that tax year.

Alternative minimum tax (AMT).

For taxpayers other than corporations, the DPAD used to determine regular tax is also used to determine alternative minimum taxable income (AMTI). Corporations use AMTI (instead of taxable income) figured without the DPAD to figure the alternative minimum DPAD used to determine AMTI.

For details, see the Instructions for Form 4626, Alternative Minimum Tax—Corporations.

Qualified Production Activities Income (QPAI)

Your allowable DPAD generally cannot be more than 3% of your QPAI. If you do not have QPAI, you generally are not allowed a DPAD. However, you do not need QPAI to claim a DPAD you are allocated as a patron of an agricultural or horticultural cooperative.

QPAI from an S corporation or partnership. QPAI is generally figured by the shareholder or partner using information provided by the S corporation or partnership on Schedule K-1. However, certain S corporations and partnerships can figure their QPAI and report each shareholder's or partner's positive or negative share on Schedule K-1. For details, see *S corporations and partnerships* on page 3. Others must give shareholders or partners the information they need to separately figure QPAI. If you must separately figure QPAI with information provided by an S corporation or partnership, see *Figuring QPAI*, on page 3.

QPAI from an estate or trust. An estate or trust will figure its QPAI and report each beneficiary's share on Schedule K-1 (Form 1041).

Figuring QPAI. QPAI is the excess (if any) of:

1. Domestic production gross receipts (DPGR), over
2. The sum of:
 - a. Cost of goods sold allocable to DPGR, and
 - b. Other expenses, losses, or deductions (other than the DPAD) allocable to DPGR.

Domestic Production Gross Receipts (DPGR)

Generally, your gross receipts (defined below) derived from the following activities are DPGR.

1. Construction of real property you perform in the United States in your construction trade or business.
2. Engineering or architectural services you perform in the United States in your engineering or architectural services trade or business for the construction of real property in the United States.
3. Any lease, rental, license, sale, exchange, or other disposition of the following.
 - a. Qualifying production property you manufacture, produce, grow or extract in whole or in significant part in the United States. See below for details.
 - b. Any qualified film you produce.
 - c. Electricity, natural gas, or potable water you produce in the United States.

However, gross receipts derived from the following activities are not DPGR.

- Activities not attributable to the actual conduct of a trade or business.
- The sale of food and beverages you prepare at a retail establishment.
- The lease, rental, or license of property between certain persons treated as a single employer.
- The lease, rental, license, sale, exchange, or other disposition of land.
- The transmission or distribution of electricity, natural gas, or potable water.

Gross receipts. Gross receipts include the following amounts from your trade or business activities.

- Total sales (net of returns and allowances).
- Amounts received for services, not including wages received as an employee.
- Income from incidental or outside sources (including sales of business property).

Gross receipts are generally not reduced by the:

- Cost of goods sold, or
- Adjusted basis of property (other than capital assets) sold or otherwise disposed of if such property is described in section 1221(a)(1) through (5).

Allocation of gross receipts.

You generally must allocate your gross receipts between DPGR and non-DPGR. Allocate gross receipts using a reasonable method that accurately identifies gross receipts that are DPGR. However, if less than 5% of your gross receipts are non-DPGR, you can treat all of your gross receipts as DPGR. Also, under the final regulations, if less than 5% of your gross receipts are DPGR, you can treat all of your gross receipts as non-DPGR.

For details, see Final Regulations section 1.199-1(d) or see section 4.03 of Notice 2005-14 and Proposed Regulations section 1.199-1(d) as discussed under *Additional Guidance* on page 1.

Qualifying production property.

The following are qualifying production property.

- Tangible personal property.
- Computer software.
- Sound recordings.

Manufacturing, producing, growing, or extracting.

Manufacturing, producing, growing, and extracting generally include the following trade or business activities.

- Activities related to manufacturing, producing, growing, extracting, installing, developing, improving, and creating qualifying production property.
- Making qualifying production property out of scrap, salvage, or junk material, or from new or raw material by processing, manipulating, refining, or changing the form of an article, or by combining or assembling two or more articles.
- Cultivating soil, raising livestock, fishing, and mining minerals.
- Storage, handling, or other processing activities (other than transportation activities) in the United States related to the sale, exchange, or other disposition of agricultural products, provided the products are consumed in connection with, or incorporated into, manufacturing, producing, growing, or extracting qualifying production property whether or not by the taxpayer.

For details, see Final Regulations section 1.199-3(e) or see section 4.04(3) of Notice 2005-14 and Proposed Regulations section 1.199-3(d) as discussed under *Additional Guidance* on page 1.

Cost of Goods Sold

For purposes of the DPAD, cost of goods sold includes the:

- Cost of goods sold to customers, and
- Adjusted basis of other property you sold or otherwise disposed of in your trade or business.

Allocation of cost of goods sold.

Generally, you must allocate your cost of goods sold between DPGR and non-DPGR using a reasonable method. If you use a method to allocate gross receipts between DPGR and non-DPGR, the use of a different method to allocate cost of goods sold will not be considered reasonable, unless it is more accurate. However, if you qualify to use the small business simplified overall method (discussed on page 4), you can use it to apportion both cost of goods sold and other deductions, expenses, and losses between DPGR and non-DPGR.

For details, see Final Regulations section 1.199-4 or see section 4.05 of Notice 2005-14 and Proposed Regulations section 1.199-4 as discussed under *Additional Guidance* on page 1.

Other Deductions, Expenses, or Losses

Other deductions, expenses, or losses include all deductions, expenses, or losses (other than cost of goods sold and employee business expenses) from a trade or business.

Allocation and apportionment of other deductions, expenses, or losses.

You can generally use one of the following three methods to allocate and apportion other trade or business deductions, expenses, or losses between DPGR and non-DPGR.

- Small business simplified overall method.
- Simplified deduction method.
- Section 861 method.

However, do not allocate and apportion a net operating loss deduction or deductions not attributable to the conduct of a trade or business to DPGR under any of the methods.

S corporations and partnerships.

An S corporation or partnership generally does not allocate and apportion its trade or business deductions, expenses, or losses between DPGR and non-DPGR. S corporations and partnerships generally report each shareholder's or partner's share of its deductions, expenses, or losses on

Schedule K-1 with other information the shareholder or partner needs to figure their DPGR. However, an S corporation or partnership with a tax year beginning before May 18, 2006, may qualify to use the small business simplified overall method to apportion both cost of goods sold and other deductions, expenses, and losses between DPGR and non-DPGR. If eligible, the S corporation or partnership can figure QPAI at the entity level and report each shareholder's or partner's share of QPAI on Schedule K-1 with other information (Form W-2 wages) the shareholder or partner needs to figure their DPGR. For details, see *Small Business Simplified Overall Method* below.

Estates and trusts. An estate or trust allocates directly allocable trade or business deductions, expenses, or losses between DPGR and non-DPGR under Regulations section 1.652(b)-3. An estate or trust that is eligible must use the simplified deduction method to allocate indirectly allocable trade or business deductions, expenses, or losses between DPGR and non-DPGR. Otherwise, the estate or trust uses the section 861 method to allocate these indirect items.

Small Business Simplified Overall Method

You generally can use the small business simplified overall method to apportion cost of goods sold and other deductions, expenses, and losses between DPGR and non-DPGR if you meet any of the following tests.

- You are engaged in the trade or business of farming and are not required to use the accrual method of accounting (see section 447).
- Your average annual gross receipts (defined below) are \$5 million or less.
- You are eligible to use the cash method of accounting under Revenue Procedure 2002-28. You can find Revenue Procedure 2002-28 on page 815 of I.R.B. 2002-18 at www.irs.gov/pub/irs-irbs/irb02-18.pdf.

Under the small business simplified overall method, your total cost of goods sold and other deductions, expenses, and losses are ratably apportioned between DPGR and non-DPGR based on relative gross receipts.

Example. Your total cost of goods sold and other trade or business deductions, expenses, or losses are \$400 and do not include a net

operating loss deduction. You have \$1,000 total gross receipts and \$750 DPGR. Your DPGR equal 75% of your total gross receipts. Under the small business simplified overall method, you subtract \$300 ($\$400 \times .75$) of your total cost of goods sold and other trade or business deductions, expenses, or losses from your DPGR to figure your QPAI.

Average annual gross receipts.

For this purpose, your average annual gross receipts are your average annual gross receipts for the preceding 3 tax years. If your business has not been in existence for 3 tax years, base your average on the period it has existed. Include any short tax years by annualizing the short tax year's gross receipts by (a) multiplying the gross receipts for the short period by 12 and (b) dividing the result by the number of months in the short period.

Excluded entities. Estates and trusts cannot use the small business simplified overall method. Also, certain oil and gas partnerships and certain partnerships owned by expanded affiliated groups cannot use the small business simplified overall method if they rely on Notice 2005-14 and the Proposed Regulations as discussed under *Additional Guidance* on page 1.

For details, see Final Regulations section 1.199-4(f) or see Proposed Regulations section 1.199-4(f)(4) as discussed under *Additional Guidance* on page 1.

S corporations and partnerships. If eligible under the above rules, an S corporation or partnership with a tax year beginning before May 18, 2006, can use the small business simplified overall method to figure QPAI, which it can then allocate to shareholders or partners on Schedule K-1. A shareholder or partner who is allocated QPAI from an S corporation or partnership must report that QPAI on line 7. However, the shareholder or partner may figure QPAI from other sources using any method for which the shareholder or partner is eligible.

Expanded affiliated groups. For additional rules that apply to expanded affiliated groups, see Final Regulations section 1.199-4(f)(4) or see section 4.05(5) of Notice 2005-14 and Proposed Regulations section 1.199-4(f)(3) as discussed under *Additional Guidance* on page 1.

Simplified Deduction Method

You generally can use the simplified deduction method to apportion other deductions, expenses, and losses

(but not cost of goods sold) between DPGR and non-DPGR if you meet either of the following tests.

- Your total trade or business assets at the end of your tax year are \$10 million or less.
- Your average annual gross receipts (defined above) are \$100 million or less (\$25 million or less if you choose not to rely on any part of the final regulations as discussed under *Additional Guidance* on page 1).

Under the simplified deduction method, your other trade or business deductions, expenses, or losses are ratably apportioned between DPGR and non-DPGR based on relative gross receipts.

Example. Your total other trade or business deductions, expenses, or losses are \$400 and do not include a net operating loss. You have \$1,000 total gross receipts and \$600 DPGR. Your DPGR equal 60% of your total gross receipts. Under the simplified deduction method, you subtract \$240 ($\$400 \times .60$) of your total other trade or business deductions, expenses, or losses from your DPGR to figure your QPAI.

S corporations and partnerships.

S corporations and partnerships cannot use the simplified deduction method to figure QPAI. See *S corporations and partnerships* on page 3.

Estates and trusts. If eligible under the above rules, an estate or trust must use the simplified deduction method to allocate its indirectly allocable trade or business deductions, expenses, or losses between DPGR and non-DPGR. All estates and trusts must allocate directly allocable deductions, expenses, or losses between DPGR and non-DPGR under Regulations section 1.652(b)-3.

Expanded affiliated groups. For additional rules that apply to expanded affiliated groups, see Final Regulations section 1.199-4(e) or see section 4.05(3)(d) of Notice 2005-14 and Proposed Regulations section 1.199-4(e)(2) as discussed under *Additional Guidance* on page 1.

Section 861 Method

You do not have to meet any tests to use the section 861 method. Under the section 861 method, you generally must apply the rules of the section 861 regulations to allocate and apportion other trade or business deductions, expenses, or losses between DPGR and non-DPGR. Section 199 is treated as an

“operative section” described in Regulations section 1.861-8(f).

For details, see Final Regulations section 1.199-4(d) or see section 4.05(3)(c) of Notice 2005-14 and Proposed Regulations section 1.199-4(d) as discussed under *Additional Guidance* on page 1.

For guidance on automatic approval to change certain elections relating to the apportionment of interest expense and research and experimentation expenditures, see Rev. Proc. 2006-42. You can find Rev. Proc. 2006-42 on page 931 of I.R.B. 2006-47 at www.irs.gov/pub/irs-irbs/irb06-47.pdf.

S corporations and partnerships.

S corporations and partnerships cannot use the section 861 method to figure QPAI. See *S corporations and partnerships* on page 3.

Estates and trusts. An estate or trust that cannot use the simplified deduction method must use the section 861 method to allocate and apportion its indirectly allocable trade or business deductions, expenses, or losses between DPGR and non-DPGR. All estates and trusts must allocate directly allocable deductions, expenses, or losses between DPGR and non-DPGR under Regulations section 1.652(b)-3.

Adjusted Gross or Taxable Income

Your allowable DPAD generally cannot be more than 3% of your adjusted gross income if you are an individual, estate, or trust (taxable income for all other taxpayers) figured without the DPAD. If you do not have adjusted gross or taxable income, you generally are not allowed a DPAD. However, you do not need adjusted gross or taxable income to claim a DPAD you are allocated as a:

- Patron of an agricultural or horticultural cooperative, or
- Member of an expanded affiliated group.

Agricultural and horticultural cooperatives. For this purpose, figure taxable income without taking into account any allowable deduction for patronage dividends, per-unit retain allocations, or nonpatronage distributions.

Estates and trusts. See the instructions for line 9 on page 6 to figure adjusted gross income.

Unrelated business taxable income (UBTI). The allowable DPAD of an organization taxed on its UBTI under section 511 generally cannot be more

than 3% of its UBTI figured without the DPAD.

Form W-2 Wages

Your allowable DPAD generally cannot be more than 50% of the Form W-2 wages you paid to your employees (including Form W-2 wages allocated to you on a Schedule K-1). If you did not pay Form W-2 wages, you generally are not allowed a DPAD. However, you do not need Form W-2 wages to claim a DPAD you are allocated as a:

Form W-2 Wages for tax years beginning after May 17, 2006.

When figuring your DPAD for a tax year beginning after May 17, 2006, the limit equal to 50% of Form W-2 wages is no longer based on Form W-2 wages from all businesses. Only wages properly allocable to DPGR are included.

Form W-2 wages from an S corporation or partnership.

An S corporation or partnership generally will figure its Form W-2 wages and report each shareholder's or partner's share on Schedule K-1. However, when figuring your DPAD for an S corporation or partnership with a tax year beginning before May 18, 2006, your allocable share of Form W-2 wages from the S corporation or partnership is limited to 6% of your share of any QPAI derived from the S corporation or partnership.

The S corporation or partnership should have applied the 6% limit for Form W-2 wages you report on line 13. However, you must apply this limit to Form W-2 wages you report on line 12. If your share of QPAI derived from an S corporation or partnership with a tax year beginning before May 18, 2006, is zero or less, you cannot use any of its Form W-2 wages to figure your DPAD.

Form W-2 wages from an estate or trust. An estate or trust generally will figure its Form W-2 wages and apportion them between the beneficiary and the fiduciary (and among the beneficiaries) and report each beneficiary's share on Schedule K-1 (Form 1041). However, when figuring your DPAD for an estate or trust with a tax year beginning before May 18, 2006, your allocable share of Form W-2 wages from the estate or trust is limited to 6% of your share of any QPAI derived from the estate or trust. The estate or trust should have applied this limit.

Figuring Form W-2 wages for tax years beginning before May 18, 2006. You can use one of the following three methods to figure your Form W-2 wages.

- Unmodified box method.
- Modified box 1 method.
- Tracking wages method.

Relevant Forms W-2. To figure your Form W-2 wages, generally use the sum of the amounts you properly report for each employee on Form W-2, Wage and Tax Statement, for the calendar year ending with or within your tax year. However, do not use any amounts reported on a Form W-2 filed with the Social Security Administration more than 60 days after its due date (including extensions).

Non-duplication rule. Amounts that are treated as Form W-2 wages for a tax year under any method cannot be treated as Form W-2 wages for any other tax year. Also, an amount cannot be treated as Form W-2 wages by more than one taxpayer.

Unmodified box method. Under the unmodified box method, Form W-2 wages are the **smaller** of:

1. The sum of the amounts reported in box 1 of the relevant Forms W-2, or
2. The sum of the amounts reported in box 5 of the relevant Forms W-2.

Modified box 1 method. Under the modified box 1 method, Form W-2 wages are figured as follows.

1. Add the amounts reported in box 1 of the relevant Forms W-2.
2. Add all the amounts described below and included in box 1 of the relevant Forms W-2.
 - a. Amounts not considered wages for federal income tax withholding purposes.
 - b. Supplemental unemployment compensation benefits.
 - c. Sick pay or annuity payments from which the recipient requested federal income tax withholding.
3. Subtract (2) from (1).
4. Add any amounts reported in box 12 of the relevant Forms W-2 that are properly coded D, E, F, G, or S.
5. Add (3) and (4).

Tracking wages method. Under the tracking wages method, Form W-2 wages are figured as follows.

1. Add the amounts reported in box 1 of the relevant Forms W-2 that are also wages for federal income tax withholding purposes.

2. Add any amounts reported in box 1 of the relevant Forms W-2 that are both:

- a. Wages for federal income tax withholding purposes, and
- b. Supplemental unemployment compensation benefits.

3. Subtract (2) from (1).

4. Add any amounts reported in box 12 of the relevant Forms W-2 that are properly coded D, E, F, G, or S.

5. Add (3) and (4).

Figuring Form W-2 wages for tax years beginning after May 17, 2006.

For tax years beginning after May 17, 2006, Form W-2 wages are generally still figured using one of the three methods listed on page 5 under *Figuring Form W-2 wages for tax years beginning before May 18, 2006*. However, as discussed on page 5, only wages properly allocable to DPGR are included and the 6% of QPAI limit on Form W-2 wages from an S corporation, partnership, estate, or trust does not apply.

More information. Additional guidance discussed below includes rules that apply to short tax years and the acquisition or disposition of a trade or business.

For more information on figuring your Form W-2 wages, see Final Regulations section 1.199-2 or section 4.02 of Notice 2005-14 and Proposed Regulations section 1.199-2 as discussed under *Additional Guidance* on page 1.

For tax years beginning before May 18, 2006, also see Rev. Proc. 2006-22. You can find Rev. Proc. 2006-22 on page 1033 of I.R.B. 2006-23 at www.irs.gov/pub/irs-irbs/irb06-23.pdf.

For tax years beginning after May 17, 2006, also see the temporary regulations issued in T.D. 9293 and Rev. Proc. 2006-47. Also see Announcement 2006-103 for corrections to T.D. 9293. You can find T.D. 9293 on page 957 of I.R.B. 2006-48 at www.irs.gov/pub/irs-irbs/irb06-48.pdf. You can find Announcement 2006-103 on page 1185 of I.R.B. 2006-52 at www.irs.gov/pub/irs-irbs/irb06-52.pdf. You can find Rev. Proc. 2006-47 on page 869 of I.R.B. 2006-45 at www.irs.gov/pub/irs-irbs/irb06-45.pdf.

Specific Instructions

Line 1 Domestic Production Gross Receipts (DPGR)

Enter your DPGR (defined on page 3).

Estates and trusts. Estates and trusts must reduce this amount if distributable net income (DNI) is distributed or required to be distributed to beneficiaries. For details, see *Estates and trusts* on page 2.

Line 2 Allocable Cost of Goods Sold

If you are not using the small business simplified overall method, enter your allocable cost of goods sold (discussed on page 3).

Estates and trusts. Estates and trusts must reduce the amount reported on line 2 if DNI is distributed or required to be distributed to beneficiaries. For details, see *Estates and trusts* on page 2.

Line 3

Estates and trusts must use Regulations section 1.652(b)-3 to allocate directly allocable trade or business deductions or losses between DPGR and non-DPGR. Enter the amount allocated to DPGR on line 3 after reducing it if DNI is distributed or required to be distributed to beneficiaries. For details, see *Estates and trusts* on page 2.

Line 4

If you are using the small business simplified overall method (discussed on page 4), enter the amount of cost of goods sold and other deductions or losses you ratably apportion to DPGR.

If you are using the simplified deduction method (also discussed on page 4), enter the other deductions or losses you ratably apportion to DPGR.

Estates and trusts. Estates and trusts must reduce this amount if DNI is distributed or required to be distributed to beneficiaries. For details, see *Estates and trusts* on page 2.

Line 7

Estates and trusts must reduce the amount reported on line 7 if DNI is distributed or required to be distributed to beneficiaries. For details, see *Estates and trusts* on page 2.

Line 9 Income Limitation

Individuals. Enter your adjusted gross income from line 37 of Form 1040 figured without the DPAD.

Corporations. Enter your taxable income from the applicable line of your tax return (for example, line 30 of Form 1120) figured without the DPAD.

Members of EAGs. See the instructions for line 18 for exceptions.

Agricultural and horticultural cooperatives. Enter your taxable income figured without the DPAD or the deductions for patronage dividends, per-unit retain allocations, and nonpatronage distributions under section 1382(b) or (c).

Estates and trusts. Enter your adjusted gross income figured without the DPAD. See the Instructions for Form 1041 to figure adjusted gross income. Use the method discussed under *How to figure AGI for estates and trusts*, under *Line 15b—Allowable Miscellaneous Itemized Deductions Subject to the 2% Floor*.

Unrelated business taxable income (UBTI). An organization taxed on its UBTI under section 511 enters its UBTI from line 34 of Form 990-T figured without the DPAD.

Line 12 Form W-2 Wages

Enter your Form W-2 wages (discussed on page 5). Do not include Form W-2 wages you must report on line 13.

Estates and trusts. Estates and trusts must reduce this amount if DNI is distributed or required to be distributed to beneficiaries. For details, see *Estates and trusts* on page 2.

Line 13

Estates and trusts must reduce the amount reported on line 13 if DNI is distributed or required to be distributed to beneficiaries. For details, see *Estates and trusts* on page 2.

Line 18 Expanded Affiliated Group Allocation

The instructions below explain how expanded affiliated groups (EAGs) (defined on page 2) figure and report the DPAD. Certain members of an expanded affiliated group may not be required to complete the entire Form 8903. See *How to Report* below.

Computation of the EAG's DPAD

In general, the DPAD for an EAG is determined by aggregating each member's taxable income or loss, QPAI, and Form W-2 wages. A member's QPAI may be positive or negative. Also, a member's taxable income or loss and QPAI are determined under the member's method of accounting.

Members with different tax years.

If members of an EAG have different tax years, in determining the DPAD of a member, the reporting member must take into account the taxable income or loss, QPAI, and Form W-2 wages of each group member that are both:

- Attributable to the period that the member of the EAG and the reporting member are both members of the EAG, and
- Taken into account in a tax year that begins after 2004 and ends with or within the tax year of the reporting member with respect to which the DPAD is figured.

For an example that explains the above requirements, see Final or Proposed Regulations section 1.199-7(h)(2) as discussed under *Additional Guidance* on page 1.

Allocation of the DPAD to Members of the EAG

The EAG's DPAD is allocated among members of the EAG based on the ratio of each member's QPAI to the total QPAI of the EAG. The allocation is made regardless of whether the EAG member has taxable income or loss or Form W-2 wages for the tax year. If a member has negative QPAI, that member's QPAI is treated as zero for purposes of the allocation.

Section 199 closing of the books method. Under the section 199 closing of the books method, a corporation's taxable income or loss, QPAI, and Form W-2 wages for the period during which the corporation was a member of the EAG are figured by treating the corporation's tax year as two separate tax years. The first

tax year is treated as ending on the close of the day on which the corporation's status as a member of the EAG changes. The second tax year is treated as beginning on the day after the corporation's status as a member of the EAG changes.

Making the section 199 closing of the books election. A corporation makes the section 199 closing of the books election by attaching the following statement to the corporation's timely filed (including extensions) federal income tax return for the tax year that includes the periods that are subject to the election: "The section 199 closing of the books election is hereby made with respect to [insert name of corporation and its employer identification number] with respect to the following periods [insert dates of two periods between which items are allocated pursuant to the closing of the books method]."

If you filed your original return on time without making the election, you can make the election on an amended return filed no later than 6 months after the due date of your tax return (excluding extensions). Enter "Filed pursuant to section 301.9100-2" at the top of the amended return.

Once made, the election is irrevocable.

Consolidated Groups

Under section 199, a consolidated group is treated as a single member of the EAG. If all members of an EAG are members of the same consolidated group, the DPAD of the consolidated group is determined based on the consolidated taxable income or loss, QPAI, and Form W-2 wages of the group and not the separate taxable income or loss, QPAI, and Form W-2 wages of its members. The consolidated group will generally file only one Form 8903. For details, see Final or Proposed Regulations section 1.199-7(d)(4) as discussed under *Additional Guidance* on page 1.

If an EAG includes both consolidated and non-consolidated members, the consolidated (not separate) taxable income or loss, QPAI, and Form W-2 wages of the consolidated group are aggregated with the taxable income or loss, QPAI, and Form W-2 wages of the non-consolidated group members to determine the DPAD. For details, see Final Regulations section 1.199-7(d)(4) or see section 4.09(4) of Notice 2005-14 and Proposed

Regulations section 1.199-7(d)(4) as discussed under *Additional Guidance* on page 1.

A consolidated group's DPAD (or the DPAD allocated to a consolidated group that is a member of an EAG) is allocated to the members of the consolidated group in proportion to each member's QPAI, if any, regardless of whether the consolidated group member has:

- Separate taxable income or loss for the tax year, and
- Form W-2 wages for the tax year.

For purposes of allocating the DPAD of a consolidated group among its members, if a consolidated group member has negative QPAI, the member's QPAI is treated as zero.

Simplified deduction and small business simplified overall methods.

For purposes of applying the simplified deduction method and the small business simplified overall method, a consolidated group determines its QPAI by reference to its members' DPGR, non-DPGR, cost of goods sold, and all other deductions, expenses, or losses, determined on a consolidated basis.

How to Report

All members of an EAG are treated as a single corporation for purposes of determining the DPAD. However, the DPAD is allocated to each member.

EAG reporting member. The EAG chooses a reporting member from amongst all members of the EAG to figure the DPAD for all EAG members with the same tax year. The reporting member completes lines 8 through 12 and lines 14 through 16 of the Form 8903 for the group.

The reporting member also does the following.

1. Enters the portion of the deduction allocated to the other members of the EAG as a negative number on line 18.
2. Completes lines 17 and 19.
3. Attaches a schedule showing how the reporting member figured its own QPAI.
4. Attaches a schedule that shows how the DPAD was figured for the group and each member's name, EIN, and share of the DPAD.
5. Provides a copy of the group DPAD computation schedule to the other members of the group.

EAG member other than the reporting member. An EAG member other than the reporting member does the following.

1. Completes a separate Form 8903, skips lines 1–16, and enters its share of the group deduction on line 18 as a positive number.
2. Completes lines 17 and 19.
3. Attaches a schedule that shows how its QPAI was figured.
4. Attaches a copy of the group DPAD computation schedule provided by the reporting member.

Consolidated groups. If the EAG is comprised of a single consolidated group, the common parent of the consolidated group completes lines 1 through 19 for the group. If the EAG is comprised of more than just the members of a single consolidated group, the common parent files a Form 8903 for the consolidated group

as either the reporting member or as an EAG member other than the reporting member, whichever is appropriate. In all events, the common parent attaches a schedule that shows the amount of the consolidated group’s DPAD allocated to each member of the consolidated group, and how the allocated amount was calculated.

Agricultural and horticultural cooperatives. Reduce the amount the cooperative deducts under section 1382 by the portion of the cooperative’s DPAD allocated to its patrons. However, the entire amount on line 19, which includes any amount allocated to patrons, is deductible under section 199 by the cooperative.

Line 19 Domestic Production Activities Deduction

Combine lines 16 through 18 and enter the result on line 19 and the appropriate line of your tax return.

Paperwork Reduction Act Notice. We ask for the information on this form to carry out the Internal Revenue laws of the United States. You are required to give us the information. We need it to ensure that you are complying with these laws and to allow us to figure and collect the right amount of tax.

You are not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and return information are confidential, as required by section 6103.

The estimated burden for individual taxpayers filing this form is approved under OMB control number 1545-0074 and is included in the estimates shown in the instructions for their individual income tax return. The estimated burden for all other taxpayers who file this form is shown below:

Recordkeeping	5 hr., 1 min.
Learning about the law or the form	13 hr., 6 min.
Preparing, copying, assembling, and sending the form to the IRS	13 hr., 46 min.

If you have comments concerning the accuracy of these time estimates or suggestions for making this form simpler, we would be happy to hear from you. See the instructions for the tax return with which this form is filed.
