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The Honorable James L. Oberstar
U.S. House of Representatives
Washington, DC 20515

Dear Mr. Oberstar:

This letter is in response to your inquiry dated February 14, 2006, on behalf of your constituent, . inquired about the publishing of final regulations relating to the "Domestic Production Deduction" under section 199 of the Internal Revenue Code (Code). He also inquired whether a corporate taxpayer may include wages paid to its officers that are reported on Form W-2 when determining the limitation on the deduction.

The Publishing of Final Regulations

The American Jobs Creation Act of 2004 (Public Law 108-357, 118 Stat. 1418), section 102, and amended by section 403(a) of the Gulf Opportunity Zone Act of 2005 (Public Law 109-135, 119 Stat. 25), added section 199 of the Code. The IRS and Treasury Department issued Notice 2005-14 (2005-7 I.R.B. 498) on January 19, 2005 providing interim guidance on section 199; on November 4, 2005, we published in the Federal Register proposed regulations under section 199 (see 70 FR 67220). On January 11, 2006, we held a public hearing on the proposed regulations.

We have received many written and electronic comments on Notice 2005-14 and the proposed regulations. Before publishing final regulations, we will carefully consider all comments received. Before publication, the IRS Office of Chief Counsel, the IRS, and the Office of Tax Policy of the Treasury Department must clear all regulations. This extensive review of regulations can result in a lengthy time period between the publication of proposed and final regulations.

The Limitation on the Domestic Production Deduction

Generally, a deduction for income attributable to domestic production activities is available to taxpayers (section 199 of the Code). The taxpayer calculates the deduction based on a certain percentage of the lesser of either the taxpayer's qualified production

activities income for the taxable year or taxable income for the taxable year (or, in the case of an individual, adjusted gross income). For taxable years beginning in 2005, that percentage is 3 percent.

However, section 199(b) limits the amount of deduction to fifty percent of the “W-2 wages” of the employer for the taxable year. In general, the term “W-2 wages” is the sum of all amounts to be reported on Form W-2, with respect to employment of employees of the taxpayer.

asks whether a corporate taxpayer can include wages paid to its officers and that it reports on Forms W-2 in this limitation on the deduction. The wages included in this calculation are wages paid to employees of the taxpayer for the calendar year ending in the taxpayer’s taxable year [Proposed Regulation Section 1.199-2(a)(1)]. The proposed regulations define “employee” as officers of a corporate taxpayer and the common law employees. Thus, a corporate taxpayer can include wages paid to a corporate officer that it reports on Form W-2 when calculating the limitation on the domestic production deduction.

I hope this information is helpful. Please contact me at _____ or
of my staff at _____ if we can be of further assistance.

Sincerely,

Marie Cashman
Special Counsel (Exempt Organizations/
Employment Tax/ Government Entities)
Tax Exempt and Government Entities