"Domestic Production Activities" Income Deduction

New Section 199 of the Internal Revenue Code

A Brief Guide to the Tax Provision

New Tax Deduction for Domestic Production Activities. New section 199 of the Tax Code provides a 9% deduction (when fully phased in) of so-called "qualifying production activities income." The deduction is phased in at 3% in 2005 and 2006, 6% in 2007 through 2009, and 9% in 2010 and thereafter.

- Qualified Production Activities Income refers to the net income from the license, sale, exchange, or other disposition of any "qualified film" produced by the taxpayer.
- The tax benefit limits the deduction for a taxable year to 50% of the W-2 wages paid by the taxpayer with respect to domestic production activities during such taxable year. The law contains special rules in determining the W-2 wage limit for non-corporate business entities, like partnerships and S corporations; impacting whether production companies should be structured as a corporation or partnership to take advantage of the new deduction.
- The deduction is generally allowed for purposes of the Alternative Minimum Tax (AMT).

Definition of Qualified Film. The deduction is available for any motion picture film or video tape (but not sexually explicit films as defined in 18 U.S. Code Section 2257), including television programming, if at least 50% of the total production compensation constitutes compensation for services performed in the United States by actors, production personnel, directors, and producers.

Effective Date. The law applies for taxable years beginning after December 31, 2004.