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In this article, the authors consider the possibility that Congress will restore the former section 199 domestic production activities deduction, and they explain the changes necessary for it to work effectively with current provisions.

During his campaign for reelection, President Trump promised a tax plan that would generally provide numerous tax cuts, including a reduction in the federal corporate tax rate from 21 percent to 15 percent but only for companies manufacturing their products in the United States. As president-elect, Trump continued to pledge to implement a tax rate reduction for U.S. manufacturers.[1] For many taxpayers and tax practitioners, those soundbites leave them wondering whether that change would mean reinstating the former domestic production activities deduction (DPAD) under section 199 that was repealed in 2017 by P.L. 115-97[2] (commonly referred to as the Tax Cuts and Jobs Act).

This article discusses the possibility that Congress revives the former section 199 deduction, or a variation of it, and why such a revival, unless specific changes are made, may not be celebrated by all domestic manufacturing companies.

What Is the DPAD?

Former section 199 was enacted by the American Jobs Creation Act of 2004[3] to provide

[1] *See, e.g.*, "Trump Tax Cuts Turn Seven," Road to 47: The Trump-Vance Transition Newsletter, Dec. 24, 2024.

[2] 131 Stat. 2054 (Dec. 22, 2017).

[3] P.L. 108-357, 118 Stat. 1418 (Oct. 22, 2004).

U.S. manufacturers, regardless of entity type, with a reduced federal income tax burden.[4]

The DPAD was available to taxpayers engaged in the domestic production of some types of property, including software, film, and sound recordings, and for specific statutorily permitted services, such as engineering or architectural services performed in the United States for the construction of real property in the United States. The deduction was generally computed as 9 percent of the lesser of the taxpayer's income from qualified production activities for the tax year, or the taxpayer's taxable income (determined without regard to the DPAD) for the tax year.[5] The amount of the deduction allowable was limited to 50 percent of the taxpayer's qualifying Form W-2 wages. The DPAD in most cases amounted to the equivalent of a 3 percent tax rate reduction on qualified income.

Former section 199 was repealed by the TCJA for tax years beginning after December 31, 2017, as part of the TCJA reducing the corporate income tax rate to 21 percent, enacting a new temporary deduction for a certain percentage of qualified business income of individuals and specified agricultural or horticultural cooperatives (that is, section 199A),[6] and simplifying the code.[7]

Why a Comeback May Be in the Cards

The proposed tax rate cut teased thus far is limited to U.S. manufacturing companies, as opposed to a widespread corporate rate cut such as the one implemented by the TCJA.[8] Because the pledged benefit has not been touted as a flat rate cut, it's plausible that Congress will seek to accomplish this goal by providing U.S. manufacturers with a permanent reduction to taxable income from specified sources to effectuate the desired rate cut. Dusting off the former section 199 rules seems like a natural solution in that case. Trump's public statements that the new proposed tax cut would be available "solely for companies that make their product in America" are certainly reminiscent of 2004 comments by then-Senate Finance Committee Chair Chuck Grassley, R-Iowa, on section 199 that "if you make it here, you get a tax cut here."[9]

Reinstating or borrowing from former section 199, rather than drafting an entirely new statute, may also be appealing to Congress and the incoming administration from a convenience standpoint. This is not only because the statutory language to institute a rate cut for U.S. manufacturers already exists under former section 199, but also because this former code section is generally already well understood by members of Congress, Treasury, and many U.S. taxpayers.

Why a Comeback Could Be Welcome

Taxpayers and tax practitioners may welcome the familiar territory if an impending tax bill incorporates all or some of the components of the former section 199. Qualifying production activities were defined broadly in the former statute and regulations; generally, taxpayers that engaged in manufacturing, producing, growing, or extracting tangible personal property within the United States qualified for the deduction. Additionally, taxpayers potentially qualified for the deduction by developing software; producing electricity, natural gas, or potable water;

[4] *See* H.R. Rep. No. 108-548, at 115 (2004); and Joint Committee on Taxation, "General Explanation of Tax Legislation Enacted in the 108th Congress," JCS-5-05, at 170 (May 2005).

[5] When enacted, the DPAD percentage was phased in starting at 3 percent for tax years beginning in 2005 and 2006; 6 percent for tax years beginning in 2007, 2008, and 2009; and 9 percent for tax years beginning after 2009. Note that a 3 percent haircut in the DPAD percentage generally applied to taxpayers with oil-related qualified production activities income. *See* former section 199(d)(9). However, with Trump's recent promises to "drill, baby, drill" in his energy policy, it seems unlikely that such a haircut would be included in any type of revived version of the DPAD. *See, e.g.*, Irie Sentner, "Greenland, Oil and 'All Hell' in the Middle East: Takeaways From Trump's Mar-a-Lago Press Conference," Politico, Jan. 7, 2025.

[6] For tax years beginning after 2017 and before 2026, section 199A generally allows a 20 percent deduction against some kinds of business income of individuals, resulting in a lower effective federal tax rate on that income. While section 199A is temporary and applies only to individuals and specified agricultural or horticultural cooperatives, repealing former section 199 for all qualifying taxpayers and reducing the corporate tax rate to 21 percent are permanent.

[7] *See* H.R. Rep. No. 115-409, at 260 (2017); and S. Prt. 115-20, at 186-187 (2017), describing the reasons for change. Although widely applicable to many taxpayers in various industries, the repeal of former section 199 resulted in a surprisingly modest $98 billion increase in revenue at that time. *See* JCT, "General Explanation of Public Law No. 115-97," JCS-1-18, at 437 (Dec. 2018).

[8] The TCJA eliminated the previous progressive corporate tax rate structure (with a maximum corporate tax rate of 35 percent) and replaced it with a flat tax rate of 21 percent for U.S. corporations.

[9] U.S. Senate Finance Committee, "Grassley Praises President's Signing of Business Tax Relief, Key Reforms Into Law" (Oct. 22, 2004).

producing films or sound recordings; constructing real property; or providing engineering or architectural services for the construction of real property. Because of the mechanics of the DPAD computations, many taxpayers in a variety of industries saw significant, permanent tax savings and reductions in their effective income tax rates under the former section 199 regime. Additionally, many taxpayers put procedures and systems in place before the repeal of former section 199 to track the attributes necessary to compute the DPAD, so a return to the prior rules may be preferred over a novel way to effectuate a rate decrease in the domestic context.

Why a Comeback May Flop

While domestic manufacturers may initially rejoice at a reinstatement of the DPAD under section 199, that joy may be short-lived for some of the largest U.S. taxpayers unless specific changes are made to former section 199. That's because of changes in the tax landscape both simultaneously with and since the repeal of former section 199.

For example, the TCJA significantly altered the U.S. international tax system, generally changing it from a worldwide to a territorial system to "level the playing field" and encourage business activities in the United States.[10] One of the provisions applicable to foreign activities of U.S. corporations enacted by the TCJA simultaneously with the repeal of former section 199 was the deduction for foreign-derived intangible income (section 250), which provides domestic corporations with reduced rates of federal income tax on their FDII. A new version of the DPAD would have to determine how it interacts with the FDII deduction under section 250, which already provides for a reduced effective rate (13 percent in 2025 and 16 percent in 2026) for a subcategory of sales and services income (deemed intangible income from export sales and services). A revived DPAD would reduce the rate on a different subcategory of domestic sales. However, the income giving rise to the FDII and new DPAD benefits would, without amendment to section 250, overlap to some degree — the DPAD benefit attached to income derived from domestic production of tangible property, whether sold in the United States or exported, versus the FDII benefit attached to income derived from sales or services to non-U.S. parties for foreign use. The rules would seemingly have to sort out whether income could be eligible for both rate reduction regimes.

If Congress determines that income couldn't be eligible for both rate reduction regimes, it could, for example, modify FDII to apply only to sales and services that don't involve domestic production and provide that the DPAD applies only to sales of products manufactured in the United States, whether for sale in the United States or for export. Alternatively, Congress could provide that the composition of FDII-eligible income stays the same and that the new DPAD is limited to U.S. production that involves no exports. Congress could alternatively decide that both provisions may apply to the same income, one after the other. If so, Congress could write an ordering rule so that the FDII deduction applies first and then the DPAD, or vice versa. The interaction involves both significant policy choices and calculation complexities.

More recently, the Inflation Reduction Act of 2022[11] enacted the corporate alternative minimum tax, a new parallel regime that generally requires large corporations to pay a minimum amount of federal income tax based on their reported financial statement income. Specifically, the corporate AMT is a minimum tax imposed solely on applicable corporations starting in tax years beginning after December 31, 2022.[12] In general, an applicable corporation is a corporation that, taking into account certain aggregation rules, averages $1 billion of adjusted financial statement income for the three tax years preceding a current year (for example, for 2021 through 2023 for a calendar-year corporation testing for 2024).[13] The corporate AMT generally imposes a 15 percent minimum tax on the financial statement income of those corporations, as adjusted by a series of rules

[10]See S. Prt. 115-20, describing the reasons for changing the U.S. international tax system.

[11]P.L. 117-169, 136 Stat. 1818 (Aug. 16, 2022).

[12]*See* sections 55(b)(2), 56A, and 59(k).

[13]Special rules apply for members of foreign-parented multinational groups.

(prescribed by the statute and administrative guidance).

Along with the repeal of former section 199, the TCJA repealed the prior corporate AMT (former corporate AMT) for tax years beginning after December 31, 2017. Before its repeal, the former corporate AMT imposed a minimum tax on a corporation's alternative minimum taxable income, which was computed as the corporation's taxable income with certain statutory adjustments.[14] The deduction under section 199 was not among the statutorily mandated adjustments to AMTI, and as the starting point for AMTI was regular taxable income, the former section 199 deduction was able to offset an applicable taxpayer's AMTI.[15] The result would not be the same under the corporate AMT, as the newer minimum tax computation begins with a taxpayer's financial statement income, adjusted by the adjustments described in section 56A(c). No DPAD-equivalent deduction exists either under the financial accounting rules or the corporate AMT rules. Therefore, reinstating former section 199 (or creating a new deduction intended to create a rate reduction) without amending section 56A(c) (or 55(b)(2)) would potentially result in large U.S. manufacturers that are applicable corporations subject to the corporate AMT missing out on the proposed benefit. However, Congress, when enacting new legislation that includes a rate reduction provision, could simultaneously amend section 56A(c) to provide an additional adjustment to financial statement income that, like many of the existing modifications, follow the tax rules.

Beyond the potential FDII and corporate AMT issues, any reinstatement of former section 199 without some modernization of the definition of qualifying activities may leave many taxpayers in some sectors, notably the technology sector, excluded from the benefit. As noted above, the development of computer software was a qualifying production activity under the former section 199 rules. However, the regulations provided that the development of online software was eligible for the benefit only if the taxpayer or a third party provided "substantially identical software" to customers via a tangible medium (such as a CD) or download. Although Congress has historically indicated that the term "software" should be construed broadly to allow for technological changes in the software industry,[16] taxpayers and the IRS clashed over the applicability of former section 199 in the software context.[17] Further, the industry, as well as its interaction with ever-changing artificial intelligence, has evolved over the past two decades so that many of the definitions and rules in former section 199, such as the requirement that software be affixed to a tangible medium or offered for download, would no longer be relevant even for many U.S. software developers that previously fell squarely within the eligibility rules for the DPAD.

Additionally, any new version of the DPAD would likely need to incorporate rules and clarifications for other areas within the former section 199 rules that were pain points for taxpayers or that the IRS perceived as being subject to abuse, such as the rules for contract manufacturing arrangements and embedded services.

Finding a Path Forward

Whether Congress will successfully negotiate a large reconciliation bill that includes tax legislation early in the new year and how that bill would incorporate Trump's promised federal income tax rate cut for U.S. manufacturers are unknown, but dusting off the former section 199 rules may be appealing to many, including congressional drafters who may be facing a quick

[14] *See* sections 56, 57, and 58.

[15] Former section 199(d)(6), however, required that the deduction be recomputed as 9 percent of the lesser of the taxpayer's income from qualified production activities (determined without regard to the AMT adjustments in sections 56 through 59) and AMTI for the tax year.

[16] See, *e.g.*, H.R. Rep. No. 105-220, at 636 (1997), referring to computer software in the context of an amendment to former section 927, a precursor to former section 199.

[17] *Bats Global Markets Holdings Inc. v. Commissioner*, 158 T.C. 118 (2022).

turnaround. However, reinstating the DPAD will likely require reworking the previous rules given that the tax landscape and certain industries have changed since its enactment and repeal.[18] ■

[18]The foregoing information is not intended to be "written advice concerning one or more Federal tax matters" subject to the requirements of section 10.37(a)(2) of Treasury Department Circular 230. The information contained here is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser. This article represents the views of only its authors and does not necessarily represent the views or professional advice of KPMG LLP.