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Instructions for Form 8903

(Rev. December 2019)

Domestic Production Activities Deduction



Department of the Treasury
Internal Revenue Service

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

Future Developments

For the latest information about developments related to Form 8903 and its instructions, such as legislation enacted after they were published, go to [IRS.gov/Form8903](https://www.irs.gov/Form8903).

Future revisions of Form 8903.

The IRS will revise the December 2018 version of Form 8903 only when necessary. Continue to use the 2018 version of Form 8903 for tax years beginning after 2017 until a new revision is issued.

What's New

Domestic production activities deduction (DPAD). DPAD under former section 199 has been repealed for tax years beginning after 2017. Taxpayers using Form 8903 to compute DPAD for tax years, or items arising from tax years, prior to repeal should use the Instructions for Form 8903 dated December 2018.

For specified agricultural or horticultural cooperatives (specified cooperatives), a deduction under section 199A(g) for income attributable to domestic production activities is available for tax years beginning after 2017. Specified cooperatives may use Form 8903, as applicable, to calculate the section 199A(g) deduction.

For further guidance, until final regulations are published in the Federal Register, taxpayers may generally rely on the Proposed Regulations (REG-118425-18), published June 19, 2019, provided the taxpayer applies the rules in their entirety and in a consistent manner. For purposes of the W-2 Wage Limitation, also see Notice 2019-27, 2019-31 IRB, page 484 available at [IRS.gov/IRB/2019-31](https://www.irs.gov/IRB/2019-31).

General Instructions

Purpose of Form

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

Your DPAD is generally 9% 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.

Reduced DPAD for oil-related QPAI.

A taxpayer with oil-related QPAI also must reduce the DPAD by 3% of the least of the following amounts.

- Oil-related QPAI.
- QPAI.
- Adjusted gross income for an individual, estate, or trust (taxable income for all other taxpayers) figured without DPAD.

DPAD limited to wages paid. Your DPAD generally can't be more than 50% of the Form W-2 wages you paid to your employees that are properly allocable to domestic production gross receipts (including Form W-2 wages allocated to you on a Schedule K-1).

Who Must File

DPAD for income attributable to domestic production activities before 2018. 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 include information provided by the S corporation or partnership when figuring their allowable DPAD. Beneficiaries of an estate or trust include information provided by the estate or trust when figuring their allowable DPAD. Patrons of certain agricultural or horticultural cooperatives may be allocated a

share of the cooperative's DPAD to include on Form 8903.

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

Note. Unless you were allocated a share of a cooperative's DPAD or you are a member of an expanded affiliated group (EAG), you won't 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 didn't pay any Form W-2 wages (or have Form W-2 wages allocated to you on a Schedule K-1), you can't claim a DPAD.

For details, see the discussions of these three items, later.

DPAD for income attributable to domestic production activities after 2017. DPAD has been repealed for tax years beginning after 2017. Don't use Form 8903 to claim DPAD for 2018 or later years unless:

1. Your tax year began before January 1, 2018,
2. You are a shareholder in an S corporation or partner in a partnership and the entity has a tax year that began before January 1, 2018,
3. You are a beneficiary of an estate or trust and the estate or trust has a tax year that began before January 1, 2018,
4. You are a patron of an agricultural or horticultural cooperative with a tax year that began before January 1, 2018.

Specified cooperatives' DPAD after 2017. For tax years beginning on or after January 1, 2018, specified agricultural or horticultural cooperatives to which part I of subchapter T applies may qualify for a deduction under section 199A(g).

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For agricultural or horticultural cooperatives' utilizing Form 8903 to compute a deduction under section 199A(g), write "SPECIFIED COOPERATIVE DPAD" across the top of Form 8903. The Form 8903 must be attached to the cooperative's return.

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 doesn't 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 aren't disallowed by a provision of the Internal Revenue Code, including the following.

- 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.

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 discussed earlier, 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.

A net operating loss under section 172 generally is figured without the section 199 deduction.

S corporations and partnerships. The DPAD is applied at the shareholder or partner level. Certain S

corporations and partnerships can figure QPAI and Form W-2 wages at the entity level and allocate and report these amounts to shareholders and partners. See [Qualified Production Activities Income \(QPAI\)](#) and [Form W-2 Wages](#) for more information.

All other S corporations and partnerships need to provide each shareholder or partner with information the shareholder or partner needs to figure the DPAD.

Film production. S corporation shareholders or partners that own 20% or more (directly or indirectly) of the capital interests in the S corporation or the partnership are treated as having engaged directly in any film produced by the S corporation or partnership, and the S corporation or partnership is treated as having engaged directly in any film produced by the S corporation shareholder or partner. See section 199(d)(1)(A)(iv) for more information.

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 earlier, when completing Form 8903 they must reduce the amounts reported on lines 8 and 18 to reflect the portion of those amounts that were allocated to beneficiaries as QPAI or Form W-2 wages. For details, see [Line 9](#), later.

Agricultural and horticultural cooperatives. Generally, an agricultural or horticultural cooperative can choose to allocate all, some, or none of its allowable DPAD (but not QPAI) to its patrons.

An agricultural or horticultural cooperative is an organization described in section 1381 that is engaged in:

- Manufacturing, producing, growing, or extracting (MPGE) in whole or significant part any agricultural or horticultural product, or
- Marketing agricultural or horticultural products that its patrons have MPGE.

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

Allocation of cooperative DPAD.

Qualified payments are the patronage dividends and per-unit retain allocations paid to patrons on which the cooperative computed its DPAD. A patron who receives a qualified payment 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 qualified payments and allocated DPAD will also be reported to patrons that aren't corporations on Form 1099-PATR, Taxable Distributions Received From Cooperatives.

Note. For purposes of section 199, patrons of agricultural or horticultural cooperatives can't include any distributions of qualified payments from the cooperative in the computation of their DPAD.

Allocation of patronage and nonpatronage income and deductions. Cooperatives must calculate the DPAD separately to determine patronage and nonpatronage income or losses for purposes of determining unused patronage or nonpatronage losses on lines 12 and 13, respectively, of Schedule G, Form 1120-C.

If you have only patronage income and deductions, complete the Form

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8903 as described in the instructions. However, if you have both patronage and nonpatronage income and deductions, see [Line 25](#) before completing Form 8903.

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 [Line 24](#) before completing Form 8903.

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

- By substituting "more than 50%" for "at least 80%" 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 on how corporations figure DPAD for AMT, see the Instructions for Form 4626.

Statistical sampling. You are generally allowed to use statistical sampling for purposes of calculating the DPAD. For details about acceptable statistical sampling methodologies, see Rev. Proc. 2007-35 and Rev. Proc. 2011-42. You can find Rev. Proc. 2007-35 on page 1349 of I.R.B. 2007-23 at [IRS.gov/pub/irs-irbs/irb07-23.pdf](#). You

can find Rev. Proc. 2011-42 on page 318 of I.R.B. 2011-37 at [IRS.gov/pub/irs-irbs/irb11-37.pdf](#).

Qualified Production Activities Income (QPAI)

Your allowable DPAD generally can't be more than 9% of your QPAI. If you don't have QPAI, you generally aren't allowed a DPAD. However, you don't need QPAI to claim a DPAD you are allocated as a patron of an agricultural or horticultural cooperative.

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) which are properly allocable to DPGR.

Oil-related QPAI. A taxpayer with oil-related QPAI must reduce the DPAD by 3% of the least of the following amounts.

- Oil-related QPAI.
- QPAI.
- Adjusted gross income for an individual, estate, or trust (taxable income for all other taxpayers) figured without the DPAD.

Oil-related QPAI is QPAI attributable to the production, refining, processing, transportation, or distribution of oil or gas, or any primary product from oil or gas (as used in section 927(a)(2)(C) before its repeal).

Costs related to transportation. When figuring QPAI and oil-related QPAI for tax years beginning after 2015, only 25% of properly allocated costs related to the transportation of oil are allocable to DPGR if the taxpayer is in the trade or business of refining crude oil and is not a major integrated oil company (as defined in section 167(h)(5)(B) without regard to clause (iii)).

Primary products from oil. Primary products from oil are oil and all products derived from the destructive distillation of oil, including volatile products, light oils such as motor fuel and kerosene, distillates such as naphtha, lubricating oils,

greases, and waxes, and residues such as fuel oil.

Primary products from gas. Primary products from gas are all gas and associated hydrocarbon components from gas or oil wells, whether recovered at the lease or upon further processing, including natural gas; condensates; liquefied petroleum gases such as ethane, propane, and butane; and liquid products such as natural gasoline.

See Temporary Regulations section 1.927(a)-1T(g)(2) for additional information.

S corporations and partnerships. S corporations and partnerships that meet specific requirements can choose to figure QPAI at the entity level and allocate QPAI to shareholders or partners. The shareholder or partner then combines the allocated portion with QPAI from other sources on Form 8903 to determine the DPAD. S corporations or partnerships that aren't eligible to figure QPAI at the entity level must report each shareholder's or partner's share of deductions, expenses, or losses on Schedule K-1 with other information the shareholder or partner needs to figure their DPAD.

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).

Cooperatives. Cooperatives figure QPAI without any deduction for patronage dividends, per-unit retain allocations, or nonpatronage distributions under section 1382(b) or (c).

Domestic Production Gross Receipts (DPGR)

Using any reasonable method that is satisfactory to the Secretary based on the facts and circumstances, you must determine whether gross receipts qualify as DPGR on an item-by-item basis (and not, for example, on a division-by-division, product line-by-product line, or transaction-by-transaction basis); however, see Regulations section 1.199-3(d)(2) for special rules and Regulations section 1.199-3(d)(3) for an exception. See Regulations section 1.199-3(d)(4) for examples.

DPGR activities. Generally, your [gross receipts](#) (defined later) derived

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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 [Qualifying Production Property](#) and [Manufacturing, producing, growing, or extracting](#), later, for details.
 - b. Any qualified film you produce.
 - c. Electricity, natural gas, or potable water you produce in the United States.

In general, gross receipts derived from the following activities aren't 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.
- Advertising and product-placement; however, see Regulations section 1.199-3(i)(5)(ii) for exceptions.
- Customer and technical support, telephone and other telecommunications services, online services (including Internet access services, online banking services, and providing access to online electronic books, newspapers, and journals), and other similar services; however, see Regulations section 1.199-3(i)(6)(iii) for exceptions.

Activities in the United States. For purposes of determining DPGR, the United States includes the 50 states, the District of Columbia, the territorial waters of the United States, and the seabed and subsoil of those submarine areas that are adjacent to the territorial waters of the United

States and over which the United States has exclusive rights, in accordance with international law, with respect to the exploration and exploitation of natural resources. The United States does not include possessions and territories of the United States or the airspace or space over the United States and these areas.

Activities in Puerto Rico. For purposes of determining DPGR, the United States includes Puerto Rico for a taxpayer who has gross receipts from sources within Puerto Rico that are subject to tax under sections 1 or 11, but only for the first 12 tax years of the taxpayer that begin after 2005 and before 2018.

Gross receipts. Your gross receipts are receipts that are recognized under your method of accounting for the tax year. 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 investments and from incidental or outside sources (including sales of business property).
- Amounts received that are allocable to the payment of sales tax or other similar state and local taxes if the tax is legally imposed on you.

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, if less than 5% of your gross receipts are DPGR, you can treat all of your gross receipts as non-DPGR.

For details, see Regulations section 1.199-1(d).

EAG partnerships. A partnership is an EAG partnership if a single EAG owns all the interests in the capital and profits of the partnership at all times during the tax year. If the requirements are met, the EAG partnership and all members of the EAG are treated as a single taxpayer for purposes of determining the amount of domestic production gross receipts (DPGR).

Special rules apply to the attribution of gross receipts (a) to a member of the EAG from the disposition of property an EAG partnership engaged in MPGE, and (b) to an EAG partnership from the disposition of property another EAG partnership engaged in MPGE, both of which are members of the same EAG. See Regulations section 1.199-3(i)(8) for more information, exceptions, and other rules.

Qualifying Production Property

The following are qualifying production property.

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

Tangible personal property.

Tangible personal property includes any tangible property other than land, buildings (including structural components), computer software, sound recordings, qualified films, electricity, natural gas, or potable water. Tangible personal property also includes any gas (other than natural gas), chemical, and similar property, such as steam, oxygen, hydrogen, or nitrogen.

Machinery, printing presses, transportation and office equipment, refrigerators, grocery counters, testing equipment, display racks and shelves, and neon and other signs that are contained in or attached to a building constitute tangible personal property.

Note. Local law doesn't control whether property is tangible personal property.

See Regulations section 1.199-3(j)(2) for more information.

Computer software. In general, computer software includes the following.

- Any program, routine, or sequence of machine-readable code that is designed to cause a computer to

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perform a desired function or set of functions, and the documentation required to describe or maintain that program or routine. An electronic book online or for download doesn't constitute computer software.

- Machine-readable code for (a) video games or similar programs, (b) equipment that is an integral part of other property, and (c) typewriters, calculators, adding and accounting machines, copiers, duplicating equipment, and similar equipment, even if the program isn't designed to operate on a computer as defined in section 168(i)(2)(B).
- Computer programs of all classes, including operating systems, executive systems, monitors, compilers and translators, assembly routines, utility programs, and application programs.
- Any incidental and ancillary rights that are necessary for the acquisition of the title to, the ownership of, or the right to use computer software, and that are used only in connection with that specific software. These incidental and ancillary rights aren't included in the definition of a trademark or trade name under Regulations section 1.197-2(b)(10)(i).

Exception. Computer software doesn't include any data or information base unless the data or information base is in the public domain and is incidental to a computer program.

Example. If a word processing program includes a dictionary feature that may be used to spell-check a document, then the entire program (including the dictionary feature) is a computer software program regardless of the form in which the dictionary feature is maintained or stored.

See Regulations section 1.199-3(j)(3) for more information.

Sound recordings. Sound recordings include any works that result from the fixation of a series of musical, spoken, or other sounds. The definition of sound recordings is limited to the master copy of the recordings (or other copy from which the holder is licensed to make and produce copies), and if the medium (such as compact discs, tapes, or other phonorecordings) in which the sounds may be embodied is tangible,

then the medium is considered tangible personal property.

Exception. Sound recordings don't include the creation of copyrighted material in a form other than a sound recording, such as lyrics or music composition.

See Regulations section 1.199-3(j)(4) for more information.

Manufacturing, producing, growing, or extracting (MPGE). MPGE 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 (QPP) 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 QPP, whether or not by the taxpayer.

Generally, the packaging, repackaging, labeling, or minor assembly of QPP does not qualify as an MPGE activity unless you engage in another MPGE activity with respect to that QPP. Furthermore, the installation of qualifying production property does not qualify as an MPGE activity unless you MPGE the qualifying production property being installed and you have the benefits and burdens of ownership of the QPP under federal income tax principles during the installation period.

For details, see Regulations section 1.199-3(e). Your MPGE of QPP must be in whole or in significant part within the United States. See Regulations section 1.199-3(f) and (g).

Qualifying in-kind partnerships. In general, partners of qualifying in-kind partnerships are treated as manufacturing, producing, growing, or

extracting the property they receive as a distribution from the partnership. For purposes of section 199, a qualifying in-kind partnership is a partnership engaged in any of the following activities.

- The extraction, refining, or processing of oil, natural gas (as described in Regulations section 1.199-3(l)(2)), petrochemicals, or products derived from oil, natural gas, or petrochemicals, in whole or significant part within the United States.
- The production or generation of electricity in the United States.
- The extraction and processing of minerals (as defined in Regulations section 1.611-1(d)(5)) within the United States.
- Any other industry or activity designated as an industry or activity of a qualifying in-kind partnership by publication in the Internal Revenue Bulletin.

For more information on qualifying in-kind partnerships, see Regulations sections 1.199-3(i)(7). For qualifying in-kind partnerships engaged solely in the extraction and processing of minerals, see Rev. Rul. 2007-30 on page 1277 of I.R.B. 2007-21 at [IRS.gov/pub/irs-irbs/irb07-21.pdf](https://www.irs.gov/pub/irs-irbs/irb07-21.pdf).

Qualified Film

A qualified film is any motion picture film, video tape, or live or delayed television programming for which 50% or more of the total compensation required to produce the film is paid for services performed by actors, production personnel, directors, and producers in the United States.

A qualified film includes the copyrights, trademarks, or other intangibles related to the film. Also, a DPAD can be taken for the production of a qualified film regardless of the methods and means by which the film is distributed.

See section 199(c)(6) and Regulations section 1.199-3(k) for more information. For special rules related to S corporations, partnerships, S corporation shareholders, and partners participating in the production of films, see [Film production](#) under *S corporations and partnerships*, earlier.

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Cost of Goods Sold

When figuring QPAI, cost of goods sold includes the:

- Cost of goods sold to customers, and
- Adjusted basis of non-inventory 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 won't be considered reasonable, unless it is more accurate. However, if you qualify to use the small business simplified overall method, you can use it to apportion both cost of goods sold and other deductions, expenses, and losses between DPGR and non-DPGR. For more information about this allocation method, see [Small Business Simplified Overall Method](#), later.

For details about allocating cost of goods sold, see Regulations section 1.199-4.

Other Deductions, Expenses, or Losses

When figuring QPAI, other deductions, expenses, or losses include all deductions, expenses, or losses from a trade or business other than cost of goods sold and employee business expenses.

Allocation and apportionment of other deductions, expenses, or losses. You must 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. (You must qualify to use this method.)
- Simplified deduction method. (You must qualify to use this method.)
- Section 861 method.

However, don't 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. S corporations and partnerships that meet specific requirements can choose to figure QPAI at the entity level and allocate the QPAI to shareholders or partners. S corporations or partnerships that aren't eligible to figure QPAI under those rules must 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 DPAD.

Estates and trusts. An estate or trust allocates directly attributable 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 attributable 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 aren't 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 Rev. Proc. 2002-28. You can find Rev. Proc. 2002-28 on page 815 of I.R.B. 2002-18 at [IRS.gov/pub/irs-irbs/irb02-18.pdf](https://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 don't 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 ($\400×0.75) of your total cost of goods sold and other trade or business deductions, expenses, or losses from your DPGR to figure your QPAI, which is \$450 ($\$750 - \300).

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 hasn't 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.

Estates and trusts. Estates and trusts can't use the small business simplified overall method.

S corporations and partnerships.

An S corporation or partnership (other than a qualifying in-kind partnership or expanded affiliated group partnership) can choose to use the small business simplified overall method to figure QPAI at the entity level and allocate that QPAI to shareholders or partners if it meets the requirements of an eligible small pass-through entity. A shareholder or partner who is allocated QPAI from an eligible small pass-through entity must report that QPAI on line 7.

For a definition of a qualifying in-kind partnership, see Regulations section 1.199-3(i)(7). For a definition of an expanded affiliated group partnership, see Regulations section 1.199-3(i)(8).

An S corporation or partnership is an eligible small pass-through entity if it meets each of the following requirements for the current tax year.

- It satisfies one of the following requirements: (a) it has average annual gross receipts for the 3 tax years preceding the current tax year of \$5 million or less, (b) it is engaged in the trade or business of farming and isn't required to use the accrual method of accounting, or (c) it is eligible to use the cash method of

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accounting under Rev. Proc. 2002-28 (that is, it has average annual gross receipts of \$10 million or less and isn't excluded from using the cash method under section 448 of the Internal Revenue Code).

- It has total cost of goods sold and deductions (excluding the net operating loss deduction) added together of \$5 million or less.
- It has DPGR.
- If a partnership, it doesn't have a partner that is an ineligible partnership (qualifying in-kind partnerships or expanded affiliated group partnerships).

Expanded affiliated groups. For additional rules that apply to expanded affiliated groups, see Regulations section 1.199-4(f)(4).

Oil-related production activities. If you have oil-related QPAI, and you choose to use the small business simplified overall method, you must allocate part of these costs to DPGR from oil-related production activities to determine oil-related QPAI. See [Line 4](#), later.

For details about the small business simplified overall method, see Regulations section 1.199-4(f).

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.

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 don't include a net operating loss. You have \$240 of cost of goods sold allocable to DPGR. 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 ($\$400 \times$

0.60) of your total other trade or business deductions, expenses, or losses from your DPGR to figure your QPAI, which is \$120 ($\$600 - \$240 - \240).

S corporations and partnerships.

An S corporation or partnership (other than a qualifying in-kind partnership or expanded affiliated group partnership) can choose to use the simplified deduction method to figure QPAI at the entity level and allocate that QPAI to shareholders or partners if it meets the requirements of an eligible widely held pass-through entity. A shareholder or partner who is allocated QPAI from an eligible widely held pass-through entity must report that QPAI on line 7.

For a definition of a qualifying in-kind partnership, see Regulations section 1.199-3(i)(7). For a definition of an expanded affiliated group partnership, see Regulations section 1.199-3(i)(8).

An S corporation or partnership is an eligible widely held pass-through entity if it meets each of the following requirements for its current tax year.

- Either of the two tests discussed earlier under [Simplified Deduction Method](#).
- It has total cost of goods sold and deductions added together of \$100 million or less.
- It has DPGR.
- On every day during the current tax year, all of its shareholders or partners are individuals, estates, or trusts described (or treated as described) in section 1361(c)(2).
- On every day during the current tax year, no shareholder or partner owns, alone or combined with the ownership interests of all related persons, more than 10% of (a) total shares of the S corporation or (b) the profits or capital interests in the partnership.

Estates and trusts. If eligible by meeting one of the two tests described earlier, an estate or trust must use the simplified deduction method to allocate its indirectly attributable trade or business deductions, expenses, or losses between DPGR and non-DPGR. All estates and trusts must allocate directly attributable 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 Regulations section 1.199-4(e)(4).

Oil-related production activities. If you have oil-related QPAI, and you choose to use the simplified deduction method, you must allocate part of these costs to DPGR from oil-related production activities to determine oil-related QPAI. See [Line 3](#), later.

Section 861 Method

You don't 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 Regulations section 1.199-4(d).

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 [IRS.gov/pub/irs-irbs/irb06-47.pdf](https://www.irs.gov/pub/irs-irbs/irb06-47.pdf).

S corporations. An S corporation can't use the section 861 method to figure QPAI. Unless it is eligible to use the small business simplified overall method or simplified deduction method, an S corporation must report each shareholder's share of its deductions, expenses, or losses on Schedule K-1 (Form 1120S) that the shareholder needs to figure their DPAD.

Partnerships. A partnership (other than a qualifying in-kind partnership or expanded affiliated group partnership) can choose to use the 861 method to figure QPAI at the entity level and allocate that QPAI to qualifying partners (defined later) if it meets the requirements of an eligible 861 partnership. A partner who is allocated QPAI from an eligible 861 partnership must report that QPAI on line 7.

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For a definition of a qualifying in-kind partnership, see Regulations section 1.199-3(i)(7). For a definition of an expanded affiliated group partnership, see Regulations section 1.199-3(i)(8).

An eligible 861 partnership must meet the following requirements for its current tax year.

- It has at least 100 partners on any day during the partnership's tax year.
- At least 70% of the partnership is owned, at all times during its tax year, by qualifying partners (defined next).
- It has DPGR.

Qualifying partner. A qualifying partner is a partner that, on each day during the partnership's tax year that the partner owns an interest in the partnership:

- Is not a general partner or a managing member of a partnership organized as a limited liability company,
- Doesn't materially participate (discussed later) in the activities of the partnership,
- Doesn't hold, alone or combined with the interests of all related persons (defined next), 5% or more of the profits or capital interests in the partnership,
- Is not an ineligible entity (qualifying in-kind partnership or expanded affiliated group partnership).

Related persons. For purposes of determining whether a partner is a qualifying partner, persons are related if they meet the requirements of sections 267(b) or 707(b), disregarding sections 267(e)(1) and (f)(1)(A).

Material participation. A qualifying partner can't materially participate in the activities of the partnership. See section 5.05 of Rev. Proc. 2007-34 for the definition of material participation.

Non-qualifying partners. An eligible 861 partnership can't allocate QPAI to non-qualifying partners (see [Qualifying partner](#), earlier). Instead, the partnership must report each non-qualifying partner's share of deductions, expenses, or losses on Schedule K-1 that the partner needs to figure their DPAD. The partnership items allocated to non-qualifying partners must be excluded for purposes of figuring QPAI at the partnership level.

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

Oil-related production activities. If you have oil-related QPAI, apply the rules of section 861 to determine the amount of other trade or business deductions, expenses, or losses to deduct for purposes of determining oil-related QPAI.

Adjusted Gross or Taxable Income

Your allowable DPAD generally can't be more than 9% 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 don't have adjusted gross or taxable income, you generally aren't allowed a DPAD.

Note. Although patrons without adjusted gross or taxable income can claim a DPAD, the DPAD can't create or increase a net operating loss under section 172(d). However, you don't need taxable income to claim a DPAD you are allocated as a member of an Expanded Affiliated Group (EAG), and the DPAD can create or increase a net operating loss under Regulations section 1.199-7(c)(2).

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 [Line 11](#), later, to figure adjusted gross income.

Unrelated business taxable income (UBTI). The allowable DPAD of an organization taxed on its UBTI under section 511 generally can't be more than 9% of its UBTI figured without the DPAD.

Form W-2 Wages

Your allowable DPAD generally can't be more than 50% of the Form W-2

wages you paid to your employees that are properly allocable to DPGR (including Form W-2 wages allocated to you on a Schedule K-1). If you didn't pay Form W-2 wages, you generally aren't allowed a DPAD. However, you don't need Form W-2 wages to claim a DPAD you are allocated as a:

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

Note. When figuring your DPAD, the limit equal to 50% of Form W-2 wages is based only on Form W-2 wages properly allocable to DPGR.

Form W-2 wages from an S corporation or partnership. S corporations and partnerships that meet specific requirements can choose to figure Form W-2 wages at the entity level and report the allocated portion of Form W-2 wages on Schedule K-1 to the S corporation shareholder or partner who then combines the allocated portion with Form W-2 wages from other sources on Form 8903 to determine the DPAD.

If the S corporation or partnership meets the requirements to be classified as one of the eligible entities listed below, it can figure Form W-2 wages at the entity level and allocate Form W-2 wages to S corporation shareholders or partners.

- Eligible small pass-through entity. See [S corporations and partnerships](#), under *Small Business Simplified Overall Method*, earlier, for the requirements.
- Eligible widely held pass-through entity. See [S corporations and partnerships](#), under *Simplified Deduction Method*, earlier, for the requirements.
- Eligible 861 partnership. See [Partnerships](#), under *Section 861 Method*, earlier, for the requirements.

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).

Form W-2 wages for services performed in Puerto Rico. Taxpayers that determine DPGR under section

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199(d)(8)(A), figure Form W-2 wages by including wages paid for services performed in Puerto Rico without regard to section 3401(a)(8), but only during the first 12 tax years of the taxpayer that begin after 2005 and before 2018.

Form W-2 wages paid to produce a qualified film. Form W-2 wages include compensation for services performed in the United States by actors, production personnel, directors, and producers to produce a qualified film. See [Qualified Film](#), earlier, for more information.

Figuring Form W-2 Wages Used To Figure the 50% Limit

You figure Form W-2 wages used to figure the 50% limit in two steps. First, you must determine the amount of wages to classify as Form W-2 wages under Regulations section 1.199-2(e) (1). Second, you must figure Form W-2 wages that are properly allocable to DPGR.

Step 1. Figuring Form W-2 Wages

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.

After you figure Form W-2 wages, see [Step 2](#), later, to determine the Form W-2 wages to report on line 16 of Form 8903.

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, don't 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).

Short tax year. If you have a short tax year, you generally will use the sum of the amounts you properly report for each employee on Form W-2 for the calendar year ending with or within that short tax year. However, if you have a short tax year that doesn't include a calendar year ending within that short tax year, then wages you properly report on Form W-2 which you paid during the short

tax year are treated as W-2 wages for that short tax year.

Acquisition or disposition of a trade or business. If you acquired or disposed of a trade or business that causes you and another employer to pay W-2 wages to employees of the acquired or disposed of trade or business during the calendar year, then the W-2 wages for the calendar year of the acquisition or disposition are allocated between each employer based on the period that the employees of the acquired or disposed of trade or business were employed by each employer. If you have a short tax year that doesn't include a calendar year ending within your short tax year, see [Short tax year](#), earlier.

Non-duplication rule. Amounts that are treated as Form W-2 wages for a tax year under any method can't be treated as Form W-2 wages for any other tax year. Also, an amount can't 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 together 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 together 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).

Step 2. Form W-2 Wages Allocable to DPGR

After you calculate Form W-2 wages, as discussed in Step 1, you must figure Form W-2 wages that are properly allocable to DPGR. You report the Form W-2 wages that are properly allocable to DPGR on line 16 of Form 8903.

You can figure Form W-2 wages that are properly allocable to DPGR under one of the following methods.

- Small business simplified overall method safe harbor.
- Wage expense safe harbor.
- Any other reasonable method based on all the facts and circumstances.

Small business simplified overall method safe harbor. If you use the small business simplified overall method to allocate costs between DPGR and non-DPGR (see [Small Business Simplified Overall Method](#), earlier), you can use the small business simplified overall method safe harbor to determine the amount of Form W-2 wages allocable to DPGR. Under this safe harbor method, the amount of Form W-2 wages that is properly allocable to DPGR equals the proportion of DPGR to total gross receipts.

Wage expense safe harbor. If you are using either the section 861 method of cost allocation under Regulations section 1.199-4(d) or the simplified deduction method under

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Regulations section 1.199-4(e), you determine the amount of wages properly allocable to DPGR by multiplying the amount of wages for the tax year by the ratio of your wage expense included in calculating QPAI for the tax year to your total wage expense used in calculating your taxable income (or adjusted gross income) for the tax year without regard to any wage expenses disallowed by sections 465, 469, 704(d), or 1366(d).

If you use the section 861 method or the simplified deduction method, you must use the same expense allocation and apportionment methods that you use to determine QPAI to allocate and apportion wage expense for purposes of the safe harbor.

Wage expense included in cost of goods sold. When figuring the ratio of your wage expense included in calculating QPAI for the tax year to your total wage expense used in calculating your adjusted gross income or taxable income (as the case may be) for the tax year, determine the wage expense included in cost of goods sold using any reasonable method based on all of the facts and circumstances. For example, it may be reasonable to use (a) the amount of direct labor included in cost of goods sold or (b) section 263A labor costs (as defined in Regulations section 1.263A-1(h)(4)(ii)) included in cost of goods sold.

More information. For more information on figuring your Form W-2 wages, see Regulations section 1.199-2 and Rev. Proc. 2006-47. You can find Rev. Proc. 2006-47 on page 869 of I.R.B. 2006-45 at [IRS.gov/pub/irs-irbs/irb06-45.pdf](https://www.irs.gov/pub/irs-irbs/irb06-45.pdf).

For more information on figuring Form W-2 wages properly allocable to DPGR, see Regulations section 1.199-2(e)(2).

Specific Instructions



Complete lines 1 through 10, column (a), only if you have oil-related production activities. All others, do not complete lines 1 through 9, column (a), and enter zero on line 10a.

Enter amounts for all activities (including oil-related production

activities) on lines 1 through 10, column (b).

Line 1 Domestic Production Gross Receipts (DPGR)

Enter your DPGR (defined earlier in the General Instructions under [Domestic Production Gross Receipts](#)).

Line 2 Allocable Cost of Goods Sold

Enter your cost of goods sold allocable to DPGR on line 2 unless you are using the small business simplified overall method. If you are using the small business simplified overall method, skip line 2, and go to [Line 4](#).

For more information about allocating costs of goods sold, see [Cost of Goods Sold](#), earlier, in the General Instructions. See [Small Business Simplified Overall Method](#), earlier in the General Instructions, for more information about using this method to allocate cost of goods sold and other deductions or losses to DPGR.

Line 3 Allocable Deductions and Losses

Enter your other deductions or losses properly allocable to DPGR on line 3 unless you are using the small business simplified overall method. If you are using the small business simplified overall method, skip line 3, and go to [Line 4](#).

If you are using the simplified deduction method, enter on line 3 the other deductions or losses you ratably apportion to DPGR. See [Simplified Deduction Method](#), earlier in the General Instructions, for more information about this method.

If you are using the section 861 method, enter on line 3 the other deductions or losses you allocate or apportion to DPGR. See [Section 861 Method](#), earlier in the General Instructions, for more information about this method.

Oil-related production activities. If you use the simplified deduction method to calculate the other deductions or losses reported on

line 3, column (b), you must make an additional calculation to determine the amount to report on line 3, column (a). Multiply the amount reported on line 3, column (b), by the ratio of oil-related DPGR reported on line 1, column (a), divided by DPGR from all activities reported on line 1, column (b). Enter the result on line 3, column (a). Don't reduce the amount reported on line 3, column (b), by this amount.

If you use the section 861 method, apply the rules of section 861 to determine the amount to report on line 3, column (a).

Line 4 Small Business Simplified Overall Method

Enter the amount of cost of goods sold and other deductions or losses you ratably apportion to DPGR using the small business simplified overall method.

Oil-related production activities. If you use the small business simplified overall method to calculate the cost of goods sold and other deductions, expenses, and losses reported on line 4, column (b), you must make an additional calculation to determine the amount to report on line 4, column (a). Multiply the amount reported on line 4, column (b), by the ratio of oil-related DPGR reported on line 1, column (a), divided by DPGR from all activities reported on line 1, column (b). Enter the amount on line 4, column (a). Don't reduce the amount reported on line 4, column (b), by this amount.

Line 7

Beneficiaries of estates and trusts, partners, and S corporation shareholders report the QPAI distributed from estates or trusts, and certain partnerships or S corporations on line 7. The QPAI should be reported to you on Schedule K-1 for Forms 1041, 1065, or 1120S. See the related Schedule K-1 and its instructions for more information.

Line 9

Estates and trusts must use Regulations section 1.652(b)-3 to allocate QPAI to beneficiaries if DNI is distributed or required to be distributed to beneficiaries. Report the amount of QPAI allocated to beneficiaries on line 9. See [Estates](#)

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[and trusts](#), earlier under *Definitions and Special Rules*.

Line 10a Oil-Related Qualified Production Activities Income

Add lines 1 through 9, column (a), to determine oil-related QPAI. If you don't have oil-related QPAI, don't complete lines 1 through 9, column (a), and enter zero on line 10a.

Line 11 Income Limitation

Individuals. Enter your adjusted gross income from line 7 of Form 1040 figured without the DPAD.

Olympic and Paralympic medals and USOC prize money. For purposes of figuring your DPAD, your adjusted gross income doesn't include the value of any medal awarded in, or any prize money received from the United States Olympic Committee on account of competition in the Olympic Games or Paralympic Games. If line 7 of your Form 1040 includes these amounts, then reduce your adjusted gross income by them before entering it on line 11.

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 [Line 24](#), later.

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 15a—Other Deductions*.

Unrelated business taxable income (UBTI). An organization taxed on its UBTI under section 511 enters its UBTI from line 38 of Form 990-T figured without the DPAD.

Note. If you have extraterritorial income (ETI), figure taxable income without regard to any claimed ETI exclusions.

See Regulations section 1.199-1(b)(1) for more information.

Line 14a

If you have oil-related qualified production income, use line 14a to determine the least of the following amounts.

- Oil-related QPAI—line 10a,
- QPAI—line 10b, or
- Adjusted gross income for an individual, estate, or trust (taxable income for all other taxpayers)—line 11.

All others, enter zero on line 14a.

Line 14b Reduction for Oil-Related Qualified Production Activities Income

If you have oil-related qualified production income, use line 14b to reduce your DPAD by 3% of the amount reported on line 14a.

All others, enter zero on line 14b.

Line 16 Form W-2 Wages

Enter your Form W-2 wages that are properly allocable to DPGR (discussed earlier under [Form W-2 Wages](#)). Don't include Form W-2 wages you must report on line 17.

Line 17

Beneficiaries of estates and trusts, partners, and S corporation shareholders report the Form W-2 wages distributed from estates or trusts, and certain partnerships or S corporations on line 17. The Form W-2 wages should be reported to you on the Schedule K-1 for Forms 1041, 1065, or 1120S. See the related Schedule K-1 and its instructions for more information.

Line 19

Estates and trusts must use Regulations section 1.652(b)-3 to allocate Form W-2 wages to beneficiaries if DNI is distributed or required to be distributed to beneficiaries. Report the amount of the Form W-2 wages allocated to beneficiaries on line 19. See [Estates](#)

[and trusts](#), earlier under *Definitions and Special Rules*.

Line 24 Expanded Affiliated Group Allocation

These instructions explain how expanded affiliated groups (EAGs) (defined earlier under *Definitions and Special Rules*) figure and report the DPAD. Certain members of an EAG may not be required to complete the entire Form 8903. See [How To Report](#), later.

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 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 Regulations section 1.199-7.

Net operating losses. The net operating loss (NOL) of a member of an EAG that is used in the computation of the EAG's taxable income isn't treated as an NOL carryback or carryover to determine the taxable income limitation in a prior or subsequent year for purposes of section 199(a)(1)(B). See Regulations section 1.199-7(b)(4) for more information.

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

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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.

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 Regulations section 1.199-7.

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 Regulations section 1.199-7(d)(4).

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, any redetermination of a corporation's receipts, cost of goods sold, or other deductions from an intercompany transaction described in Regulations section 1.1502-13(c)(1)(i) or (c)(4) isn't taken into account, and 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 with the same tax year to figure the DPAD for all EAG members (computing members). The reporting member completes lines 10a through 16 and lines 18 through 22 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 (including non-computing members) as a negative number on line 24.
2. Completes lines 23 and 25.
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 computing members of the group.

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

1. Completes a separate Form 8903, skips lines 1–22, and enters its share of the group deduction on line 24 as a positive number.
2. Completes lines 23 and 25.
3. Attaches a schedule showing how the computing member figured its own QPAI.
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 25 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.

Line 25 Domestic Production Activities Deduction

Combine lines 22 through 24 and enter the result on line 25. For Form 1040 returns filed after tax year 2017, include the result from line 25 of Form 8903 on Schedule 1 (Form 1040), line 36. For Form 1120 returns filed after tax year 2017, enter the result from line 25 of Form 8903 on line 26, Other deductions.

For tax years beginning after December 31, 2017, additional guidance under section 199A(g) is pending.

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 25, which includes any amount allocated to patrons, is deductible under section 199 by the cooperative. See [Agricultural and horticultural cooperatives](#) in the General Instructions for more information on this subject.

How to report. Cooperatives aren't permitted to net patronage losses with nonpatronage income. Therefore, they must figure taxable income from patronage or nonpatronage activities separately on Schedule G, Form 1120-C.

Patronage income and deductions only. Cooperatives that have only patronage income and deductions generally complete Form 8903 as described earlier in the instructions.

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Patronage and nonpatronage income and deductions. For tax years beginning before January 1, 2018, cooperatives with both patronage and nonpatronage income or deductions must follow the instructions below for completing Form 8903.

Report the total amount of the DPAD to be claimed on Form 1120-C on line 25 of Form 8903, and leave lines 1 through 24 blank. Attach to Form 8903 separate calculations of the DPAD from patronage and nonpatronage activities, which

conform to lines 1 through 24 of Form 8903.

Enter the DPAD from patronage and nonpatronage sources reported on the attachment on line 6a, column (a), Patronage, and line 6a, column (b), Nonpatronage, respectively, of Schedule G, Form 1120-C.

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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 time needed to complete and file this form will vary depending on individual circumstances. 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., 58 min.
Learning about the law or the form	7 hr., 33 min.
Preparing, copying, assembling, and sending the form to the IRS	7 hr., 58 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.