“(3) **Tax-exempt assets not taken into account.**—For purposes of”, and
(B) by striking subparagraph (B).
(7) Section 903 is amended by striking “114, 164(a),” and inserting “164(a)”.
(8) Section 999(c)(1) is amended by striking “941(a)(5),”.
(c) **Effective date.**—The amendments made by this section shall apply to transactions after December 31, 2004.
(d) **Transitional rule for 2005 and 2006.**—
(1) In general.—In the case of transactions during 2005 or 2006, the amount includible in gross income by reason of the amendments made by this section shall not exceed the applicable percentage of the amount which would have been so included but for this subsection.
(2) Applicable percentage.—For purposes of paragraph (1), the applicable percentage shall be as follows:
(A) For 2005, the applicable percentage shall be 20 percent.
(B) For 2006, the applicable percentage shall be 40 percent.
(e) **Revocation of election to be treated as domestic corporation.**—If, during the 1-year period beginning on the date of the enactment of this Act, a corporation for which an election is in effect under section 943(e) of the Internal Revenue Code of 1986 revokes such election, no gain or loss shall be recognized with respect to property treated as transferred under clause (ii) of section 943(e)(4)(B) of such Code to the extent such property—
(1) was treated as transferred under clause (i) thereof, or
(2) was acquired during a taxable year to which such election applies and before May 1, 2003, in the ordinary course of its trade or business.
The Secretary of the Treasury (or such Secretary’s delegate) may prescribe such regulations as may be necessary to prevent the abuse of the purposes of this subsection.
(f) **Binding contracts.**—The amendments made by this section shall not apply to any transaction in the ordinary course of a trade or business which occurs pursuant to a binding contract—
(1) which is between the taxpayer and a person who is not a related person (as defined in section 943(b)(3) of such Code, as in effect on the day before the date of the enactment of this Act), and
(2) which is in effect on September 17, 2003, and at all times thereafter.
For purposes of this subsection, a binding contract shall include a purchase option, renewal option, or replacement option which is included in such contract and which is enforceable against the seller or lessor.

**SEC. 102. Deduction relating to income attributable to domestic production activities.**

(a) In general.—Part VI of subchapter B of chapter 1 (relating to itemized deductions for individuals and corporations) is amended by adding at the end the following new section:

“**SEC. 199. Income attributable to domestic production activities.**

“(a) Allowance of deduction.—
“(1) **In General.**—There shall be allowed as a deduction an amount equal to 9 percent of the lesser of—

(A) the qualified production activities income of the taxpayer for the taxable year, or

(B) taxable income (determined without regard to this section) for the taxable year.

“(2) **Phase In.**—In the case of any taxable year beginning after 2004 and before 2010, paragraph (1) and subsections (d)(1) and (d)(6) shall be applied by substituting for the percentage contained therein the transition percentage determined under the following table:

<table>
<thead>
<tr>
<th>For taxable years</th>
<th>The transition percentage is:</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005 or 2006</td>
<td>3</td>
</tr>
<tr>
<td>2007, 2008, or 2009</td>
<td>6</td>
</tr>
</tbody>
</table>

“(b) **Deduction Limited to Wages Paid.**—

“(1) **In General.**—The amount of the deduction allowable under subsection (a) for any taxable year shall not exceed 50 percent of the W–2 wages of the employer for the taxable year.

“(2) **W–2 Wages.**—For purposes of paragraph (1), the term ‘W–2 wages’ means the sum of the aggregate amounts the taxpayer is required to include on statements under paragraphs (3) and (8) of section 6051(a) with respect to employment of employees of the taxpayer during the calendar year ending during the taxpayer’s taxable year.

“(3) **Acquisitions and Dispositions.**—The Secretary shall provide for the application of this subsection in cases where the taxpayer acquires, or disposes of, the major portion of a trade or business or the major portion of a separate unit of a trade or business during the taxable year.

“(c) **Qualified Production Activities Income.**—For purposes of this section—

“(1) **In General.**—The term ‘qualified production activities income’ for any taxable year means an amount equal to the excess (if any) of—

(A) the taxpayer’s domestic production gross receipts for such taxable year, over

(B) the sum of—

(i) the cost of goods sold that are allocable to such receipts,

(ii) other deductions, expenses, or losses directly allocable to such receipts, and

(iii) a ratable portion of other deductions, expenses, and losses that are not directly allocable to such receipts or another class of income.

“(2) **Allocation Method.**—The Secretary shall prescribe rules for the proper allocation of items of income, deduction, expense, and loss for purposes of determining income attributable to domestic production activities.

“(3) **Special Rules for Determining Costs.**—

(A) **In General.**—For purposes of determining costs under clause (i) of paragraph (1)(B), any item or service brought into the United States shall be treated as acquired by purchase, and its cost shall be treated as not less than its value immediately after it entered the United States. A
similar rule shall apply in determining the adjusted basis of leased or rented property where the lease or rental gives rise to domestic production gross receipts.

“(B) EXPORTS FOR FURTHER MANUFACTURE.—In the case of any property described in subparagraph (A) that had been exported by the taxpayer for further manufacture, the increase in cost or adjusted basis under subparagraph (A) shall not exceed the difference between the value of the property when exported and the value of the property when brought back into the United States after the further manufacture.

“(4) DOMESTIC PRODUCTION GROSS RECEIPTS.—

“(A) IN GENERAL.—The term ‘domestic production gross receipts’ means the gross receipts of the taxpayer which are derived from—

“(i) any lease, rental, license, sale, exchange, or other disposition of—

“(I) qualifying production property which was manufactured, produced, grown, or extracted by the taxpayer in whole or in significant part within the United States,

“(II) any qualified film produced by the taxpayer, or

“(III) electricity, natural gas, or potable water produced by the taxpayer in the United States,

“(ii) construction performed in the United States, or

“(iii) engineering or architectural services performed in the United States for construction projects in the United States.

“(B) EXCEPTIONS.—Such term shall not include gross receipts of the taxpayer which are derived from—

“(i) the sale of food and beverages prepared by the taxpayer at a retail establishment, and

“(ii) the transmission or distribution of electricity, natural gas, or potable water.

“(5) QUALIFYING PRODUCTION PROPERTY.—The term ‘qualifying production property’ means—

“(A) tangible personal property,

“(B) any computer software, and

“(C) any property described in section 168(f)(4).

“(6) QUALIFIED FILM.—The term ‘qualified film’ means any property described in section 168(f)(3) if not less than 50 percent of the total compensation relating to the production of such property is compensation for services performed in the United States by actors, production personnel, directors, and producers. Such term does not include property with respect to which records are required to be maintained under section 2257 of title 18, United States Code.

“(7) RELATED PERSONS.—

“(A) IN GENERAL.—The term ‘domestic production gross receipts’ shall not include any gross receipts of the taxpayer derived from property leased, licensed, or rented by the taxpayer for use by any related person.
“(B) RELATED PERSON.—For purposes of subparagraph (A), a person shall be treated as related to another person if such persons are treated as a single employer under subsection (a) or (b) of section 52 or subsection (m) or (o) of section 414, except that determinations under subsections (a) and (b) of section 52 shall be made without regard to section 1563(b).

“(d) DEFINITIONS AND SPECIAL RULES.—

“(1) APPLICATION OF SECTION TO PASS-THRU ENTITIES.—

“(A) IN GENERAL.—In the case of an S corporation, partnership, estate or trust, or other pass-thru entity—

“(i) subject to the provisions of paragraphs (2) and (3), this section shall be applied at the shareholder, partner, or similar level, and

“(ii) the Secretary shall prescribe rules for the application of this section, including rules relating to—

“(I) restrictions on the allocation of the deduction to taxpayers at the partner or similar level, and

“(II) additional reporting requirements.

“(B) APPLICATION OF WAGE LIMITATION.—Notwithstanding subparagraph (A)(i), for purposes of applying subsection (b), a shareholder, partner, or similar person which is allocated qualified production activities income from an S corporation, partnership, estate, trust, or other pass-thru entity shall also be treated as having been allocated W-2 wages from such entity in an amount equal to the lesser of—

“(i) such person’s allocable share of such wages (without regard to this subparagraph), as determined under regulations prescribed by the Secretary, or

“(ii) 2 times 9 percent of the qualified production activities income allocated to such person for the taxable year.

“(2) APPLICATION TO INDIVIDUALS.—In the case of an individual, subsection (a)(1)(B) shall be applied by substituting ‘adjusted gross income’ for ‘taxable income’. For purposes of the preceding sentence, adjusted gross income shall be determined—

“(A) after application of sections 86, 135, 137, 219, 221, 222, and 469, and

“(B) without regard to this section.

“(3) PATRONS OF AGRICULTURAL AND HORTICULTURAL CO-OPERATIVES.—

“(A) IN GENERAL.—If any amount described in paragraph (1) or (3) of section 1385(a)—

“(i) is received by a person from an organization to which part I of subchapter T applies which is engaged—

“(I) in the manufacturing, production, growth, or extraction in whole or significant part of any agricultural or horticultural product, or

“(II) in the marketing of agricultural or horticultural products, and
“(ii) is allocable to the portion of the qualified production activities income of the organization which, but for this paragraph, would be deductible under subsection (a) by the organization and is designated as such by the organization in a written notice mailed to its patrons during the payment period described in section 1382(d),
then such person shall be allowed a deduction under subsection (a) with respect to such amount. The taxable income of the organization shall not be reduced under section 1382 by reason of any amount to which the preceding sentence applies.

“(B) Special rules.—For purposes of applying subparagraph (A), in determining the qualified production activities income which would be deductible by the organization under subsection (a)—

“(i) there shall not be taken into account in computing the organization’s taxable income any deduction allowable under subsection (b) or (c) of section 1382 (relating to patronage dividends, per-unit retain allocations, and nonpatronage distributions), and

“(ii) in the case of an organization described in subparagraph (A)(i)(II), the organization shall be treated as having manufactured, produced, grown, or extracted in whole or significant part any qualifying production property marketed by the organization which its patrons have so manufactured, produced, grown, or extracted.

“(4) Special rule for affiliated groups.—

“(A) In general.—All members of an expanded affiliated group shall be treated as a single corporation for purposes of this section.

“(B) Expanded affiliated group.—For purposes of this section, the term ‘expanded affiliated group’ means an affiliated group as defined in section 1504(a), determined—

“(i) by substituting ‘50 percent’ for ‘80 percent’ each place it appears, and

“(ii) without regard to paragraphs (2) and (4) of section 1504(b).

“(C) Allocation of deduction.—Except as provided in regulations, the deduction under subsection (a) shall be allocated among the members of the expanded affiliated group in proportion to each member’s respective amount (if any) of qualified production activities income.

“(5) Trade or business requirement.—This section shall be applied by only taking into account items which are attributable to the actual conduct of a trade or business.

“(6) Coordination with minimum tax.—The deduction under this section shall be allowed for purposes of the tax imposed by section 55; except that for purposes of section 55, the deduction under subsection (a) shall be 9 percent of the lesser of—

“(A) qualified production activities income (determined without regard to part IV of subchapter A), or
“(B) alternative minimum taxable income (determined without regard to this section) for the taxable year. In the case of an individual, subparagraph (B) shall be applied by substituting ‘adjusted gross income’ for ‘alternative minimum taxable income’. For purposes of the preceding sentence, adjusted gross income shall be determined in the same manner as provided in paragraph (2).

“(7) REGULATIONS.—The Secretary shall prescribe such regulations as are necessary to carry out the purposes of this section.”

(b) MINIMUM TAX.—Section 56(g)(4)(C) (relating to disallowance of items not deductible in computing earnings and profits) is amended by adding at the end the following new clause:

“(v) DEDUCTION FOR DOMESTIC PRODUCTION.—Clause (i) shall not apply to any amount allowable as a deduction under section 199.”.

(c) SPECIAL RULE RELATING TO ELECTION TO TREAT CUTTING OF TIMBER AS A SALE OR EXCHANGE.—Any election under section 631(a) of the Internal Revenue Code of 1986 made for a taxable year ending on or before the date of the enactment of this Act may be revoked by the taxpayer for any taxable year ending after such date. For purposes of determining whether such taxpayer may make a further election under such section, such election (and any revocation under this section) shall not be taken into account.

(d) TECHNICAL AMENDMENTS.—

(1) Sections 86(b)(2)(A), 135(c)(4)(A), 137(b)(3)(A), and 219(g)(3)(A)(ii) are each amended by inserting “199,” before “221”.

(2) Clause (i) of section 221(b)(2)(C) is amended by inserting “199,” before “222”.

(3) Clause (i) of section 222(b)(2)(C) is amended by inserting “199,” before “911”.

(4) Paragraph (1) of section 246(b) is amended by inserting “199,” after “172”.

(5) Clause (iii) of section 469(i)(3)(F) is amended by inserting “199,” before “219”.

(6) Subsection (a) of section 613 is amended by inserting “and without the deduction under section 199” after “without allowances for depletion”.

(7) Subsection (a) of section 1402 is amended by striking “and” at the end of paragraph (14), by striking the period at the end of paragraph (15) and inserting “, and”, and by inserting after paragraph (15) the following new paragraph:

“(16) the deduction provided by section 199 shall not be allowed.”.

(8) The table of sections for part VI of subchapter B of chapter 1 is amended by adding at the end the following new item:

“Sec. 199. Income attributable to domestic production activities.”.

(e) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2004.