

## § 1.199-7

\$1,000,000 received by the patrons from Cooperative X is not taken into account for purposes of section 199 in the hands of the patrons.

[T.D. 9263, 71 FR 31283, June 1, 2006; 72 FR 6, Jan. 3, 2007; T.D. 9317, 72 FR 12973, Mar. 20, 2007]

### § 1.199-7 Expanded affiliated groups.

(a) *In general.* The provisions of this section apply solely for purposes of section 199 of the Internal Revenue Code (Code). All members of an expanded affiliated group (EAG) are treated as a single corporation for purposes of section 199. Notwithstanding the preceding sentence, except as otherwise provided in the Code and regulations (see, for example, sections 199(c)(7) and 267, §1.199-3(b), paragraph (a)(3) of this section, and the consolidated return regulations), each member of an EAG is a separate taxpayer that computes its own taxable income or loss, qualified production activities income (QPAI) (as defined in §1.199-1(c)), and W-2 wages (as defined in §1.199-2(e)). If members of an EAG are also members of a consolidated group, see paragraph (d) of this section.

(1) *Definition of expanded affiliated group.* An EAG is an affiliated group as defined in section 1504(a), determined by substituting *more than 50 percent* for *at least 80 percent* each place it appears and without regard to section 1504(b)(2) and (4).

(2) *Identification of members of an expanded affiliated group—(i) In general.* A corporation must determine if it is a member of an EAG on a daily basis.

(ii) *Becoming or ceasing to be a member of an expanded affiliated group.* If a corporation becomes or ceases to be a member of an EAG, the corporation is treated as becoming or ceasing to be a member of the EAG at the end of the day on which its status as a member changes.

(3) *Attribution of activities—(i) In general.* If a member of an EAG (the disposing member) derives gross receipts (as defined in §1.199-3(c)) from the lease, rental, license, sale, exchange, or other disposition (as defined in §1.199-3(i)) of qualifying production property (QPP) (as defined in §1.199-3(j)) that was manufactured, produced, grown or extracted (MPGE) (as defined in §1.199-

### 26 CFR Ch. I (4-1-11 Edition)

3(e)), in whole or in significant part (as defined in §1.199-3(g)) in the United States (as defined in §1.199-3(h)), a qualified film (as defined in §1.199-3(k)), or electricity, natural gas, or potable water (as defined in §1.199-3(l)) (collectively, utilities) that was produced in the United States, such property was MPGE or produced by another corporation (or corporations), and the disposing member is a member of the same EAG as the other corporation (or corporations) at the time that the disposing member disposes of the QPP, qualified film, or utilities, then the disposing member is treated as conducting the previous activities conducted by such other corporation (or corporations) with respect to the QPP, qualified film, or utilities in determining whether its gross receipts are domestic production gross receipts (DPGR) (as defined in §1.199-3(a)). With respect to a lease, rental, or license, the disposing member is treated as having disposed of the QPP, qualified film, or utilities on the date or dates on which it takes into account the gross receipts derived from the lease, rental, or license under its methods of accounting. With respect to a sale, exchange, or other disposition, the disposing member is treated as having disposed of the QPP, qualified film, or utilities on the date on which it ceases to own the QPP, qualified film, or utilities for Federal income tax purposes, even if no gain or loss is taken into account.

(ii) *Special rule.* Attribution of activities does not apply for purposes of the construction of real property under §1.199-3(m) or the performance of engineering and architectural services under §1.199-3(n). A member of an EAG must engage in a construction activity under §1.199-3(m)(2), provide engineering services under §1.199-3(n)(2), or provide architectural services under §1.199-3(n)(3) in order for the member's gross receipts to be derived from construction, engineering, or architectural services.

(4) *Examples.* The following examples illustrate the application of paragraph (a)(3) of this section. Assume that all taxpayers are calendar year taxpayers. The examples are as follows:

**Internal Revenue Service, Treasury****§ 1.199–7**

*Example 1.* Corporations M and N are members of the same EAG. M is engaged solely in the trade or business of manufacturing furniture in the United States that it sells to unrelated persons. N is engaged solely in the trade or business of engraving companies' names on pens and pencils purchased from unrelated persons and then selling the pens and pencils to such companies. For purposes of this example, assume that if N was not a member of an EAG, its activities would not qualify as MPGE. Accordingly, although M's sales of the furniture qualify as DPGR (assuming all the other requirements of §1.199–3 are met), N's sales of the engraved pens and pencils do not qualify as DPGR because neither N nor another member of the EAG MPGE the pens and pencils.

*Example 2.* For the entire 2007 year, Corporations A and B are members of the same EAG. A is engaged solely in the trade or business of MPGE machinery in the United States. A and B each own 45% of partnership C and unrelated persons own the remaining 10%. C is engaged solely in the trade or business of MPGE the same type of machinery in the United States as A. In 2007, B purchases and then resells the machinery MPGE in 2007 by A and C. B also resells machinery it purchases from unrelated persons. If only B's activities were considered, B would not qualify for the deduction under §1.199–1(a) (section 199 deduction). However, because at the time B disposes of the machinery B is a member of the EAG that includes A, B is treated as conducting A's previous MPGE activities in determining whether B's gross receipts from the sale of the machinery MPGE by A are DPGR. C is not a member of the EAG and thus C's MPGE activities are not attributed to B in determining whether B's gross receipts from the sale of the machinery MPGE by C are DPGR. Accordingly, B's gross receipts attributable to its sale of the machinery it purchases from A are DPGR (assuming all the other requirements of §1.199–3 are met). B's gross receipts attributable to its sale of the machinery it purchases from C and from the unrelated persons are non-DPGR because no member of the EAG MPGE the machinery and because C does not qualify as an EAG partnership.

*Example 3.* The facts are the same as in *Example 2* except that rather than reselling the machinery, B rents the machinery to unrelated persons and B takes the gross receipts attributable to the rental of the machinery into account under its methods of accounting in 2007, 2008, and 2009. In addition, as of the close of business on December 31, 2008, A and B cease to be members of the same EAG. With respect to the machinery acquired from C and the unrelated persons, B's gross receipts attributable to the rental of the machinery in 2007, 2008, and 2009 are non-DPGR because no member of the EAG MPGE the machinery and because C does not qualify as

an EAG partnership. With respect to machinery acquired from A, B's gross receipts in 2007 and 2008 attributable to the rental of the machinery are DPGR because at the time B takes into account the gross receipts derived from the rental of the machinery under its methods of accounting, B is a member of the same EAG as A and B is treated as conducting A's previous MPGE activities. However, with respect to the rental receipts in 2009, because A and B are not members of the same EAG in 2009, B's rental receipts are non-DPGR.

*Example 4.* For the entire 2007 year, Corporation P owns over 50% of the stock of Corporation S. In 2007, P MPGE QPP in the United States and transfers the QPP to S. On February 28, 2008, P disposes of stock of S, reducing P's ownership of S below 50% and P and S cease to be members of the same EAG. On June 30, 2008, S sells the QPP to an unrelated person. Unless P's transfer of the QPP to S took place in a transaction to which section 381(a) applies (see §1.199–8(e)(3)), because S is not a member of the same EAG as P on June 30, 2008, S is not treated as conducting the activities conducted by P in determining if S's receipts are DPGR, notwithstanding that P and S were members of the same EAG when P MPGE the QPP and when P transferred the QPP to S.

*Example 5.* For the entire 2007 year, Corporations X and Y are unrelated corporations. In 2007, X MPGE QPP in the United States and sells the QPP to Y. On August 31, 2008, X acquires over 50% of the stock of Y, thus making X and Y members of the same EAG. On November 30, 2008, Y sells the QPP to an unrelated person. Because X and Y are members of the same EAG on November 30, 2008, Y is treated as conducting the activities conducted by X in 2007 in determining if Y's receipts are DPGR, notwithstanding that X and Y were not members of the same EAG when X MPGE the QPP nor when X sold the QPP to Y.

(5) *Anti-avoidance rule.* If a transaction between members of an EAG is engaged in or structured with a principal purpose of qualifying for, or increasing the amount of, the section 199 deduction of the EAG or the portion of the section 199 deduction allocated to one or more members of the EAG, adjustments must be made to eliminate the effect of the transaction on the computation of the section 199 deduction.

(b) *Computation of expanded affiliated group's section 199 deduction—(1) In general.* The section 199 deduction for an EAG is determined by the EAG by aggregating each member's taxable income or loss, QPAI, and W-2 wages, if

## § 1.199-7

## 26 CFR Ch. I (4-1-11 Edition)

any. For purposes of this determination, a member's QPAI may be positive or negative. A member's taxable income or loss and QPAI shall be determined by reference to the member's methods of accounting.

(2) *Example.* The following example illustrates the application of paragraph (b)(1) of this section:

*Example.* Corporations X, Y, and Z, calendar year taxpayers, are the only members of an EAG and are not members of a consolidated group. X has taxable income of \$50,000, QPAI of \$15,000, and W-2 wages of \$1,000. Y has taxable income of (\$20,000), QPAI of (\$1,000), and W-2 wages of \$750. Z has \$0 taxable income and \$0 QPAI, but has W-2 wages of \$2,000. In determining the EAG's section 199 deduction, the EAG aggregates each member's taxable income or loss, QPAI, and W-2 wages. Accordingly, the EAG has taxable income of \$30,000 (\$50,000 + (\$20,000) + \$0), QPAI of \$14,000 (\$15,000 + (\$1,000) + \$0), and W-2 wages of \$3,750 (\$1,000 + \$750 + \$2,000).

(3) *Net operating loss carrybacks and carryovers.* In determining the taxable income of an EAG, if a member of an EAG has a net operating loss (NOL) carryback or carryover to the taxable year, then the amount of the NOL used to offset taxable income cannot exceed the taxable income of that member.

(4) *Losses used to reduce taxable income of expanded affiliated group—(i) In general.* The amount of an NOL sustained by any member of an EAG that is used in the year sustained in determining an EAG's taxable income limitation under section 199(a)(1)(B) is not treated as an NOL carryover or NOL carryback to any taxable year in determining the taxable income limitation under section 199(a)(1)(B). For purposes of this paragraph (b)(4), an NOL is considered to be used if it reduces an EAG's aggregate taxable income, regardless of whether the use of the NOL actually reduces the amount of the section 199 deduction that the EAG would otherwise derive. An NOL is not considered to be used to the extent that it reduces an EAG's aggregate taxable income to an amount less than zero. If more than one member of an EAG has an NOL used in the same taxable year to reduce the EAG's taxable income, the members' respective NOLs are deemed used in proportion to the amount of their NOLs.

(ii) *Examples.* The following examples illustrate the application of this paragraph (b)(4). For purposes of these examples, assume that all relevant parties have sufficient W-2 wages so that the section 199 deduction is not limited under section 199(b)(1). The examples read as follows:

*Example 1.* (i) *Facts.* Corporations A and B are the only two members of an EAG. A and B are both calendar year taxpayers, and they do not join in the filing of a consolidated Federal income tax return. Neither A nor B had taxable income or loss prior to 2010. In 2010, A has QPAI and taxable income of \$1,000, and B has QPAI of \$1,000 and an NOL of \$1,500. In 2011, A has QPAI of \$2,000 and taxable income of \$1,000 and B has QPAI of \$2,000 and taxable income prior to the NOL deduction allowed under section 172 of \$2,000.

(ii) *Section 199 deduction for 2010.* In determining the EAG's section 199 deduction for 2010, A's \$1,000 of QPAI and B's \$1,000 of QPAI are aggregated, as are A's \$1,000 of taxable income and B's \$1,500 NOL. Thus, for 2010, the EAG has QPAI of \$2,000 and taxable income of (\$500). The EAG's section 199 deduction for 2010 is 9% of the lesser of its QPAI or its taxable income. Because the EAG has a taxable loss in 2010, the EAG's section 199 deduction is \$0.

(iii) *Section 199 deduction for 2011.* In determining the EAG's section 199 deduction for 2011, A's \$2,000 of QPAI and B's \$2,000 of QPAI are aggregated, giving the EAG QPAI of \$4,000. Also, \$1,000 of B's NOL from 2010 was used in 2010 to reduce the EAG's taxable income to \$0. The remaining \$500 of B's 2010 NOL is not considered to have been used in 2010 because it reduced the EAG's taxable income below \$0. Accordingly, for purposes of determining the EAG's taxable income limitation under section 199(a)(1)(B) in 2011, B is deemed to have only a \$500 NOL carryover from 2010 to offset a portion of its 2011 taxable income. Thus, B's taxable income in 2011 is \$1,500 which is aggregated with A's \$1,000 of taxable income. The EAG's taxable income limitation in 2011 is \$2,500. The EAG's section 199 deduction is 9% of the lesser of its QPAI of \$4,000 or its taxable income of \$2,500. Thus, the EAG's section 199 deduction in 2011 is 9% of \$2,500, or \$225. The results would be the same if neither A nor B had QPAI in 2010.

*Example 2.* The facts are the same as in *Example 1* except that in 2010 B was not a member of the same EAG as A, but instead was a member of an EAG with Corporation X, which had QPAI and taxable income of \$1,000 in 2010, and had neither taxable income nor loss in any other year. There were no other members of the EAG in 2010 besides B and X, and B and X did not file a consolidated Federal income tax return. As \$1,000 of B's NOL

**Internal Revenue Service, Treasury****§ 1.199–7**

was used in 2010 to reduce the B and X EAG's taxable income to \$0. B is considered to have only a \$500 NOL carryover from 2010 to offset a portion of its 2011 taxable income for purposes of the taxable income limitation under section 199(a)(1)(B), just as in *Example 1*. Accordingly, the results for the A and B EAG in 2011 are the same as in *Example 1*.

*Example 3.* The facts are the same as in *Example 1* except that B is not a member of any EAG in 2011. Because \$1,000 of B's NOL was used in 2010 to reduce the EAG's taxable income to \$0, B is considered to have only a \$500 NOL carryover from 2010 to offset a portion of its 2011 taxable income for purposes of the taxable income limitation under section 199(a)(1)(B), just as in *Example 1*. Thus, for purposes of determining B's taxable income limitation in 2011, B is considered to have taxable income of \$1,500, and B has a section 199 deduction of 9% of \$1,500, or \$135.

*Example 4.* Corporations A, B, and C are the only members of an EAG. A, B, and C are all calendar year taxpayers, and they do not join in the filing of a consolidated Federal income tax return. None of the EAG members (A, B, or C) had taxable income or loss prior to 2010. In 2010, A has QPAI of \$2,000 and taxable income of \$1,000, B has QPAI of \$1,000 and an NOL of \$1,000, and C has QPAI of \$1,000 and an NOL of \$3,000. In 2011, prior to the NOL deduction allowed under section 172, A and B each has taxable income of \$200 and C has taxable income of \$5,000. In determining the EAG's section 199 deduction for 2010, A's QPAI of \$2,000, B's QPAI of \$1,000, and C's QPAI of \$1,000 are aggregated, as are A's taxable income of \$1,000, B's NOL of \$1,000, and C's NOL of \$3,000. Thus, for 2010, the EAG has QPAI of \$4,000 and taxable income of (\$3,000). In determining the EAG's taxable income limitation under section 199(a)(1)(B) in 2011, \$1,000 of B's and C's aggregate NOLs in 2010 of \$4,000 are considered to have been used in 2010 to reduce the EAG's taxable income to \$0, in proportion to their NOLs. Thus, \$250 of B's NOL from 2010 ( $\$1,000 \times \$1,000 / \$4,000$ ) and \$750 of C's NOL from 2010 ( $\$1,000 \times \$3,000 / \$4,000$ ) are deemed to have been used in 2010. The remaining \$750 of B's NOL and the remaining \$2,250 of C's NOL are not deemed to have been used because so doing would have reduced the EAG's taxable income in 2010 below \$0. Accordingly, for purposes of determining the EAG's taxable income limitation in 2011, B is deemed to have a \$750 NOL carryover from 2010 and C is deemed to have a \$2,250 NOL carryover from 2010. Thus, for purposes of determining the EAG's taxable income limitation, B's taxable income in 2011 is \$0 and C's taxable income in 2011 is \$2,750, which are aggregated with A's \$200 taxable income. B's unused NOL carryover from 2010 cannot be used to reduce either A's or C's 2011 taxable income. Thus, the EAG's taxable income limitation in 2011 is \$2,950, A's taxable income of \$200

plus B's taxable income of \$0 plus C's taxable income of \$2,750.

(c) *Allocation of an expanded affiliated group's section 199 deduction among members of the expanded affiliated group*—(1) *In general.* An EAG's section 199 deduction as determined in paragraph (b)(1) of this section is allocated among the members of the EAG in proportion to each member's QPAI, regardless of whether the EAG member has taxable income or loss or W-2 wages for the taxable year. For this purpose, if a member has negative QPAI, the QPAI of the member shall be treated as zero.

(2) *Use of section 199 deduction to create or increase a net operating loss.* Notwithstanding § 1.199–1(b), if a member of an EAG has some or all of the EAG's section 199 deduction allocated to it under paragraph (c)(1) of this section and the amount allocated exceeds the member's taxable income (determined prior to allocation of the section 199 deduction), the section 199 deduction will create an NOL for the member. Similarly, if a member of an EAG, prior to the allocation of some or all of the EAG's section 199 deduction to the member, has an NOL for the taxable year, the portion of the EAG's section 199 deduction allocated to the member will increase the member's NOL.

(d) *Special rules for members of the same consolidated group*—(1) *Intercompany transactions.* In the case of an intercompany transaction between consolidated group members S and B (as the terms intercompany transaction, S, and B are defined in § 1.1502–13(b)(1)), S takes the intercompany transaction into account in computing the section 199 deduction at the same time and in the same proportion as S takes into account the income, gain, deduction, or loss from the intercompany transaction under § 1.1502–13.

(2) *Attribution of activities in the construction of real property and the performance of engineering and architectural services.* Notwithstanding paragraph (a)(3)(ii) of this section, a disposing member (as described in paragraph (a)(3)(i) of this section) is treated as conducting the previous activities conducted by each other member of its consolidated group with respect to the construction of real property under

## § 1.199-7

## 26 CFR Ch. I (4-1-11 Edition)

§ 1.199-3(m) and the performance of engineering and architectural services under § 1.199-3(n), but only with respect to activities performed during the period of consolidation.

(3) *Application of the simplified deduction method and the small business simplified overall method.* For purposes of applying the simplified deduction method under § 1.199-4(e) and the small business simplified overall method under § 1.199-4(f), a consolidated group determines its QPAI using its members' DPGR, non-DPGR, cost of goods sold (CGS), and all other deductions, expenses, or losses (deductions), determined after application of § 1.1502-13.

(4) *Determining the section 199 deduction—(i) Expanded affiliated group consists of consolidated group and non-consolidated group members.* In determining the section 199 deduction, if an EAG includes corporations that are members of the same consolidated group and corporations that are not members of the same consolidated group, the consolidated taxable income or loss, QPAI, and W-2 wages, if any, of the consolidated group (and not the separate taxable income or loss, QPAI, and W-2 wages of the members of the consolidated group), are aggregated with the taxable income or loss, QPAI, and W-2 wages, if any, of the non-consolidated group members. For example, if A, B, C, S1, and S2 are members of the same EAG, and A, S1, and S2 are members of the same consolidated group (the A consolidated group), then the A consolidated group is treated as one member of the EAG. Accordingly, the EAG is considered to have three members, the A consolidated group, B, and C. The consolidated taxable income or loss, QPAI, and W-2 wages, if any, of the A consolidated group are aggregated with the taxable income or loss, QPAI, and W-2 wages, if any, of B and C in determining the EAG's section 199 deduction.

(ii) *Expanded affiliated group consists only of members of a single consolidated group.* If all the members of an EAG are members of the same consolidated group, the consolidated group's section 199 deduction is determined using the consolidated group's consolidated taxable income or loss, QPAI, and W-2 wages, rather than the separate tax-

able income or loss, QPAI, and W-2 wages of its members.

(5) *Allocation of the section 199 deduction of a consolidated group among its members.* The section 199 deduction of a consolidated group (or the section 199 deduction 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 consolidated group member's QPAI, regardless of whether the consolidated group member has separate taxable income or loss or W-2 wages for the taxable year. In allocating the section 199 deduction of a consolidated group among its members, any redetermination of a corporation's receipts, CGS, or other deductions from an intercompany transaction under § 1.1502-13(c)(1)(i) or (c)(4) for purposes of section 199 is not taken into account. Also, for purposes of this allocation, if a consolidated group member has negative QPAI, the QPAI of the member shall be treated as zero.

(e) *Examples.* The following examples illustrate the application of paragraphs (a) through (d) of this section:

*Example 1.* Corporations X and Y are members of the same EAG but are not members of a consolidated group. All the activities described in this example take place during the same taxable year. X and Y each use the section 861 method described in § 1.199-4(d) for allocating and apportioning their deductions. X incurs \$5,000 in costs in manufacturing a machine, all of which are capitalized. X is entitled to a \$1,000 depreciation deduction for the machine in the current taxable year. X rents the machine to Y for \$1,500. Y uses the machine in manufacturing QPP within the United States. Y incurs \$1,400 of CGS in manufacturing the QPP. Y sells the QPP to unrelated persons for \$7,500. Pursuant to section 199(c)(7) and § 1.199-3(b), X's rental income is non-DPGR (and its related costs are not attributable to DPGR). Accordingly, Y has \$4,600 of QPAI (Y's \$7,500 DPGR received from unrelated persons—Y's \$1,400 CGS allocable to such receipts—Y's \$1,500 of rental expense), X has \$0 of QPAI, and the EAG has \$4,600 of QPAI.

*Example 2.* The facts are the same as in *Example 1* except that X and Y are members of the same consolidated group. Pursuant to section 199(c)(7) and § 1.199-3(b), X's rental income ordinarily would not be DPGR (and its related costs would not be allocable to DPGR). However, because X and Y are members of the same consolidated group, § 1.1502-13(c)(1)(i) provides that the separate entity

## Internal Revenue Service, Treasury

## § 1.199-7

attributes of X's intercompany items or Y's corresponding items, or both, may be redetermined in order to produce the same effect as if X and Y were divisions of a single corporation. If X and Y were divisions of a single corporation, X and Y would have QPAI of \$5,100 (\$7,500 DPGR received from unrelated persons - \$1,400 CGS allocable to such receipts - \$1,000 depreciation deduction). To obtain this same result for the consolidated group, X's rental income is redetermined as DPGR, which results in the consolidated group having \$9,000 of DPGR (the sum of Y's DPGR of \$7,500 + X's DPGR of \$1,500) and \$3,900 of costs allocable to DPGR (the sum of Y's \$1,400 CGS + Y's \$1,500 rental expense + X's \$1,000 depreciation expense). For purposes of determining how much of the consolidated group's section 199 deduction is allocated to X and Y, pursuant to paragraph (d)(5) of this section, the redetermination of X's rental income as DPGR under §1.1502-13(c)(1)(i) is not taken into account (X's costs are considered to be allocable to DPGR because they are allocable to the consolidated group deriving DPGR). Accordingly, for this purpose, X is deemed to have (\$1,000) of QPAI (X's \$0 DPGR - X's \$1,000 depreciation deduction). Because X is deemed to have negative QPAI, also pursuant to paragraph (d)(5) of this section, X's QPAI is treated as zero. Y has \$4,600 of QPAI (Y's \$7,500 DPGR - Y's \$1,400 CGS allocable to such receipts - Y's \$1,500 of rental expense). Accordingly, X is allocated \$0/(\$0 + \$4,600) of the consolidated group's section 199 deduction and Y is allocated \$4,600/(\$0 + \$4,600) of the consolidated group's section 199 deduction.

*Example 3.* Corporations P and S are members of the same EAG but are not members of a consolidated group. P and S each use the section 861 method for allocating and apportioning their deductions and are both calendar year taxpayers. In 2007, P incurs \$1,000 in research and development expenses in creating an intangible asset and deducts these expenses in 2007. P anticipates that it will license the intangible asset to S. On January 1, 2008, P licenses the intangible asset to S for \$2,500. S uses the intangible asset in manufacturing QPP within the United States. S incurs \$2,000 of additional costs in manufacturing the QPP. On December 31, 2008, S sells the QPP to unrelated persons for \$10,000. Because on December 31, 2007, P anticipates that it will license the intangible asset to S, a related person, and also because the intangible asset is not QPP, P's license receipts from S will be non-DPGR. Accordingly, P's research and development expenses in 2007 are not attributable to DPGR. In 2008, S has \$5,500 of QPAI (S's \$10,000 DPGR received from unrelated persons - S's \$2,000 additional costs in manufacturing the QPP - S's \$2,500 of license expense). P has \$0 of QPAI, and the EAG has \$5,500 of QPAI.

*Example 4. (i) Determination of consolidated group's QPAI.* The facts are the same as in Example 3 except that P and S are members of the same consolidated group. Pursuant to section 199(c)(7) and § 1.199-3(b), and also because the intangible asset is not QPP, P's license income ordinarily would not be DPGR (and its related costs would not be allocable to DPGR). However, because P and S are members of the same consolidated group, §1.1502-13(c)(1)(i) provides that the separate entity attributes of P's intercompany items or S's corresponding items, or both, may be redetermined in order to produce the same effect as if P and S were divisions of a single corporation. If P and S were divisions of a single corporation, in 2007 the single corporation would have \$1,000 of expenses allocable to the anticipated DPGR from the sale of the QPP to unrelated persons, resulting in a negative QPAI (from this individual item) of \$1,000. In 2008, the single corporation would have QPAI of \$8,000 (\$10,000 DPGR received from unrelated persons - \$2,000 additional costs in manufacturing the QPP). To obtain this same result for the consolidated group, P's license income from S is redetermined as DPGR. P's research and development expenses are allocable to DPGR. This results in the consolidated group having negative QPAI in 2007 (from the research and development expense) of \$1,000. In 2008, the consolidated group has \$12,500 of DPGR (the sum of S's DPGR of \$10,000 + P's DPGR of \$2,500) and \$4,500 of costs allocable to DPGR (the sum of S's \$2,000 additional costs + S's \$2,500 license expense), resulting in \$8,000 of QPAI in 2008.

*(ii) Allocation of deduction.* Since the consolidated group has no QPAI in 2007, there is no section 199 deduction to be allocated between P and S in 2007. In 2008, the consolidated group has \$8,000 of QPAI and, assuming that the group has positive taxable income and W-2 wages, the consolidated group will have a section 199 deduction. For purposes of determining how much of the consolidated group's section 199 deduction is allocated to P and S, pursuant to paragraph (d)(5) of this section, the redetermination of P's license income as DPGR under §1.1502-13(c)(1)(i) is not taken into account. Accordingly, for purposes of allocating the consolidated group's section 199 deduction between P and S, P is deemed to have \$0 DPGR and \$0 QPAI in 2008. S has \$5,500 of QPAI (S's \$10,000 DPGR - S's \$2,000 in additional costs allocable to such receipts - S's \$2,500 of license expense). Accordingly, P is allocated \$0/(\$0 + \$5,500) of the consolidated group's section 199 deduction in 2008 and S is allocated \$5,500/(\$0 + \$5,500) of the consolidated group's section 199 deduction.

*Example 5. (i) Facts.* Corporations A and B are the only two members of an EAG but are not members of a consolidated group. A and B each file Federal income tax returns on a calendar year basis. The average annual

## § 1.199-7

gross receipts of the EAG are less than or equal to \$100,000,000 and A and B each use the simplified deduction method under § 1.199-4(e). In 2007, A has \$10,000,000 of DPGR from sales of televisions to unrelated persons and \$2,000,000 of DPGR from sales of televisions to B. In addition, A has gross receipts from computer consulting services with unrelated persons of \$3,000,000. A has CGS of \$6,000,000. A is able to determine from its books and records that \$4,500,000 of its CGS are attributable to televisions sold to unrelated persons and \$1,500,000 are attributable to televisions sold to B (see § 1.199-4(b)(2)). A has other deductions of \$4,000,000. A has no other items of income, gain, or deductions. In 2007, B sells the televisions it purchased from A to unrelated persons for \$4,100,000. B also pays \$100,000 for administrative services performed in 2007. B has no other items of income, gain, or deductions.

(ii) *QPAI.* (A) *A's QPAI.* In order to determine A's QPAI, A subtracts its \$6,000,000 CGS from its \$12,000,000 DPGR. Under the simplified deduction method, A then apportions its remaining \$4,000,000 of deductions to DPGR in proportion to the ratio of its DPGR to total gross receipts. Thus, of A's \$4,000,000 of deductions, \$3,200,000 is apportioned to DPGR ( $\$4,000,000 \times \$12,000,000 / \$15,000,000$ ). Accordingly, A's QPAI is \$2,800,000 (\$12,000,000 DPGR - \$6,000,000 CGS - \$3,200,000 deductions apportioned to its DPGR).

(B) *B's QPAI.* Although B did not MPGE the televisions it sold, pursuant to paragraph (a)(3) of this section, B is treated as conducting A's MPGE of the televisions in determining whether B's gross receipts are DPGR. Thus, B has \$4,100,000 of DPGR. In order to determine B's QPAI, B subtracts its \$2,000,000 CGS from its \$4,100,000 DPGR. Under the simplified deduction method, B then apportions its remaining \$100,000 of deductions to DPGR in proportion to the ratio of its DPGR to total gross receipts. Thus, because B has no other gross receipts, all of B's \$100,000 of deductions is apportioned to DPGR ( $\$100,000 \times \$4,100,000 / \$4,100,000$ ). Accordingly, B's QPAI is \$2,000,000 (\$4,100,000 DPGR - \$2,000,000 CGS - \$100,000 deductions apportioned to its DPGR).

*Example 6. (i) Facts.* The facts are the same as in *Example 5* except that A and B are members of the same consolidated group. B does not sell the televisions purchased from A until 2008, and B's \$100,000 paid for administrative services are paid in 2008 for services performed in 2008. In addition, in 2008, A has \$3,000,000 in gross receipts from computer consulting services with unrelated persons and \$1,000,000 in related deductions.

(ii) *Consolidated group's 2007 QPAI.* The consolidated group's DPGR and total gross receipts in 2007 are \$10,000,000 and \$13,000,000, respectively, because, pursuant to paragraph (d)(1) of this section and § 1.1502-13, the sale

## 26 CFR Ch. I (4-1-11 Edition)

of the televisions from A to B is not taken into account in 2007. In order to determine the consolidated group's QPAI, the consolidated group subtracts its \$4,500,000 CGS from the televisions sold to unrelated persons from its \$10,000,000 DPGR. Under the simplified deduction method, the consolidated group apportions its remaining \$4,000,000 of deductions to DPGR in proportion to the ratio of its DPGR to total gross receipts. Thus, \$3,076,923 ( $\$4,000,000 \times \$10,000,000 / \$13,000,000$ ) is allocated to DPGR. Accordingly, the consolidated group's QPAI for 2007 is \$2,423,077 (\$10,000,000 DPGR - \$4,500,000 CGS - \$3,076,923 deductions apportioned to its DPGR).

(iii) *Allocation of consolidated group's 2007 section 199 deduction to its members.* Because B's only activity during 2007 is the purchase of televisions from A, B has no DPGR or deductions and thus, no QPAI, in 2007. Accordingly, the entire section 199 deduction in 2007 for the consolidated group will be allocated to A.

(iv) *Consolidated group's 2008 QPAI.* Pursuant to paragraph (d)(1) of this section and § 1.1502-13(c), A's sale of televisions to B in 2007 is taken into account in 2008 when B sells the televisions to unrelated persons. However, because A and B are members of a consolidated group, § 1.1502-13(c)(1)(i) provides that the separate entity attributes of A's intercompany items or B's corresponding items, or both, may be redetermined in order to produce the same effect as if A and B were divisions of a single corporation. Accordingly, A's \$2,000,000 of gross receipts are redetermined to be non-DPGR and as not being gross receipts for purposes of allocating costs between DPGR and non-DPGR, and B's \$2,000,000 CGS are redetermined to be not allocable to DPGR. Notwithstanding that A's receipts are redetermined to be non-DPGR and as not being gross receipts for purposes of allocating costs between DPGR and non-DPGR, A's CGS are still considered to be allocable to DPGR because they are allocable to the consolidated group deriving DPGR. Accordingly, the consolidated group's DPGR in 2008 is \$4,100,000 from B's sales of televisions, and its total receipts are \$7,100,000 (\$4,100,000 DPGR plus \$3,000,000 non-DPGR from A's computer consulting services). To determine the consolidated group's QPAI, the consolidated group subtracts A's \$1,500,000 CGS from the televisions sold to B from its \$4,100,000 DPGR. Under the simplified deduction method, the consolidated group apportions its remaining \$1,100,000 of deductions (\$1,000,000 from A and \$100,000 from B) to DPGR in proportion to the consolidated group's ratio of its DPGR to total gross receipts. Thus, \$635,211 ( $\$1,100,000 \times \$4,100,000 / \$7,100,000$ ) is allocated to DPGR. Accordingly, the consolidated group's QPAI for 2008 is \$1,964,789 (\$4,100,000 DPGR - \$1,500,000 CGS - \$635,211 deductions apportioned to its

## Internal Revenue Service, Treasury

## § 1.199-7

DPGR), the same QPAI that would result if A and B were divisions of a single corporation.

(v) *Allocation of consolidated group's 2008 section 199 deduction to its members.* (A) *A's QPAI.* For purposes of allocating the consolidated group's section 199 deduction to its members, pursuant to paragraph (d)(5) of this section, the redetermination of A's \$2,000,000 in receipts is disregarded. Accordingly, for this purpose, A's DPGR are \$2,000,000 (receipts from the sale of televisions to B taken into account in 2008) and its total receipts are \$5,000,000 (\$2,000,000 DPGR + \$3,000,000 non-DPGR from its computer consulting services). In determining A's QPAI, A subtracts its \$1,500,000 CGS from the televisions sold to B from its \$2,000,000 DPGR. Under the simplified deduction method, A apportions its remaining \$1,000,000 of deductions in proportion to the ratio of its DPGR to total receipts. Thus, \$400,000 ( $\$1,000,000 \times \$2,000,000/\$5,000,000$ ) is allocated to DPGR. Thus, A's QPAI is \$100,000 ( $\$2,000,000 \text{ DPGR} - \$1,500,000 \text{ CGS} - \$400,000 \text{ deductions allocated to its DPGR}$ ).

(B) *B's QPAI.* B's DPGR and its total gross receipts are each \$4,100,000. For purposes of allocating the consolidated group's section 199 deduction to its members, pursuant to paragraph (d)(5) of this section, the redetermination of B's \$2,000,000 CGS as not allocable to DPGR is disregarded. In determining B's QPAI, B subtracts its \$2,000,000 CGS from the televisions purchased from A from its \$4,100,000 DPGR. Under the simplified deduction method, B apportions its remaining \$100,000 deductions in proportion to the ratio of its DPGR to total receipts. Thus, all \$100,000 ( $\$100,000 \times \$4,100,000/\$4,100,000$ ) is allocated to DPGR. Thus, B's QPAI is \$2,000,000 ( $\$4,100,000 \text{ DPGR} - \$2,000,000 \text{ CGS} - \$100,000 \text{ deductions allocated to its DPGR}$ ).

(C) *Allocation to A and B.* Pursuant to paragraph (d)(5) of this section, the consolidated group's section 199 deduction for 2008 is allocated  $\$100,000/(\$100,000 + \$2,000,000)$  to A and  $\$2,000,000/(\$100,000 + \$2,000,000)$  to B.

*Example 7.* Corporations S and B are members of the same consolidated group that files its Federal income tax returns on a calendar year basis. In 2007, S manufactures office furniture for B to use in B's corporate headquarters and S sells the office furniture to B. S and B have no other activities in the taxable year. If S and B were not members of a consolidated group, S's gross receipts from the sale of the office furniture to B would be DPGR (assuming all the other requirements of § 1.199-3 are met) and S's CGS or other deductions, expenses, or losses from the sale to B would be allocable to S's DPGR. However, because S and B are members of a consolidated group, the separate entity attributes of S's intercompany items or B's corresponding items, or both, may be redeter-

mined under § 1.1502-13(c)(1)(i) or (c)(4) in order to produce the same effect as if S and B were divisions of a single corporation. If S and B were divisions of a single corporation, there would be no DPGR with respect to the office furniture because there would be no lease, rental, license, sale, exchange, or other disposition of the furniture by the single corporation (and no CGS or other deductions allocable to DPGR). Thus, in order to produce the same effect as if S and B were divisions of a single corporation, S's gross receipts are redetermined as non-DPGR. Accordingly, the consolidated group has no DPGR (and no CGS or other deductions allocated or apportioned to DPGR) and receives no section 199 deduction in 2007.

*Example 8.* (i) *Facts.* A and B are members of the same consolidated group that files its Federal income tax returns on a calendar year basis. On January 1, 2007, A MPGE QPP which is 10-year recovery property for \$100 and depreciates it under the straight-line method. On January 1, 2009, A sells the property to B for \$130. Under section 168(i)(7), B is treated as A for purposes of section 168 to the extent B's \$130 basis does not exceed A's adjusted basis at the time of the sale. B's additional basis is treated as new 10-year recovery property for which B elects the straight-line method of recovery. (To simplify the example, the half-year convention is disregarded.)

(ii) *Depreciation; intercompany gain.* A claims \$10 of depreciation for each taxable year 2007 and 2008 and has an \$80 basis at the time of the sale to B. Thus, A has a \$50 intercompany gain from its sale to B. For each taxable year 2009 through 2016, B has \$10 of depreciation with respect to \$80 of its basis (the portion of its \$130 basis not exceeding A's adjusted basis) and \$5 of depreciation with respect to the \$50 of its additional basis that exceeds A's adjusted basis. For each taxable year 2017 and 2018, B has \$5 of depreciation with respect to the \$50 of its additional basis that exceeds A's adjusted basis.

(iii) *Timing.* A's \$50 gain is taken into account to reflect the difference for each consolidated return year between B's depreciation taken into account with respect to the property and the depreciation that would have been taken into account if A and B were divisions of a single corporation. For each taxable year 2009 through 2016, B takes into account \$15 of depreciation rather than the \$10 of depreciation that would have been taken into account if A and B were divisions of a single corporation. For each taxable year 2017 and 2018, B takes into account \$5 of depreciation rather than the \$0 of depreciation that would have been taken into account if A and B were divisions of a single corporation (the QPP would have been fully depreciated after the 2016 taxable year if A and B were divisions of a single corporation). Thus, A takes \$5 of gain into account in each

## § 1.199-7

## 26 CFR Ch. I (4-1-11 Edition)

of the 2009 through 2018 taxable years (10% of its \$50 gain). Pursuant to § 1.199-7(d)(1), A takes its sale to B into account in computing the section 199 deduction at the same time and in the same proportion as A takes into account the income, gain, deduction, or loss from the intercompany transaction under § 1.1502-13. Thus, in each taxable year 2009 through 2018, A takes into account \$13 of gross receipts (10% of its \$130 gross receipts) from the sale to B. The group's income in each taxable year 2009 through 2016 is a \$10 loss (\$5 gain-\$5 depreciation), the same net amount it would have been if A and B were divisions of a single corporation. The group's income in each taxable year 2017 and 2018 is \$0 (\$5 gain-\$5 depreciation), the same net amount it would have been if A and B were divisions of a single corporation.

(iv) *Attributes.* If A and B were not members of a consolidated group, A's gross receipts on the sale of the QPP to B would be DPGR (assuming all the other requirements of § 1.199-3 are met). However, because A and B are members of a consolidated group, the separate entity attributes of A's DPGR may be redetermined under § 1.1502-13(c)(1)(i) or (c)(4) in order to produce the same effect as if A and B were divisions of a single corporation. If A and B were divisions of a single corporation, there would be no DPGR with respect to the QPP because there would be no lease, rental, license, sale, exchange, or other disposition of the QPP by the single corporation (and no CGS or other deductions allocable to DPGR). Thus, in order to produce the same effect as if A and B were divisions of a single corporation, A's \$13 of gross receipts taken into account in each year is redetermined as non-DPGR. Accordingly, the consolidated group has no DPGR (and no CGS or other deductions allocable or apportioned to DPGR) and receives no section 199 deduction.

*Example 9.* Corporations X, Y, and Z are members of the same EAG but are not members of a consolidated group. X, Y, and Z each files Federal income tax returns on a calendar year basis. Assume that the EAG has W-2 wages in excess of the section 199(b) wage limitation. Prior to 2007, X had no taxable income or loss. In 2007, X has \$0 of taxable income and \$2,000 of QPAI, Y has \$4,000 of taxable income and \$3,000 of QPAI, and Z has \$4,000 of taxable income and \$5,000 of QPAI. Accordingly, the EAG has taxable income of \$8,000, the sum of X's taxable income of \$0, Y's taxable income of \$4,000, and Z's taxable income of \$4,000. The EAG has QPAI of \$10,000, the sum of X's QPAI of \$2,000, Y's QPAI of \$3,000, and Z's QPAI of \$5,000. Because X's, Y's, and Z's taxable years all began in 2007, the transition percentage under section 199(a)(2) is 6%. Thus, the EAG's section 199 deduction for 2007 is \$480 (6% of the lesser of the EAG's taxable income of \$8,000 or the EAG's QPAI of \$10,000). Pursu-

ant to paragraph (c)(1) of this section, the \$480 section 199 deduction is allocated to X, Y, and Z in proportion to their respective amounts of QPAI, that is \$96 to X ( $\$480 \times \$2,000/\$10,000$ ), \$144 to Y ( $\$480 \times \$3,000/\$10,000$ ), and \$240 to Z ( $\$480 \times \$5,000/\$10,000$ ). Although X's taxable income for 2007 determined prior to allocation of a portion of the EAG's section 199 deduction to it was \$0, pursuant to paragraph (c)(2) of this section X will have an NOL for 2007 equal to \$96. Because X's NOL for 2007 cannot be carried back to a previous taxable year, X's NOL carryover to 2008 will be \$96.

*Example 10.* (i) *Facts.* Corporation P owns all of the stock of Corporations S and B. P, S, and B file a consolidated Federal income tax return on a calendar year basis. P, S, and B each uses the section 861 method for allocating and apportioning their deductions. In 2010, S MPGE QPP in the United States at a cost of \$1,000. On November 30, 2010, S sells the QPP to B for \$2,500. On February 28, 2011, P sells 60% of the stock of B to X, an unrelated person. On June 30, 2011, B sells the QPP to U, another unrelated person, for \$3,000.

(ii) *Consolidated group's 2010 QPAI.* Because S and B are members of a consolidated group in 2010, pursuant to § 1.199-7(d)(1) and § 1.1502-13, neither S's \$1,500 of gain on the sale of QPP to B nor S's \$2,500 gross receipts from the sale are taken into account in 2010. Accordingly, neither S nor B has QPAI in 2010.

(iii) *Consolidated group's 2011 QPAI.* B becomes a nonmember of the consolidated group at the end of the day on February 28, 2011, the date on which P sells 60% of the B stock to X. Under § 1.199-7(d)(1) and § 1.1502-13(d), S takes the intercompany transaction into account immediately before B becomes a nonmember of the consolidated group. Pursuant to § 1.1502-13(d)(1)(ii)(A)(I), because the QPP is owned by B, a nonmember of the consolidated group immediately after S's gain is taken into account, B is treated as selling the QPP to a nonmember for \$2,500, B's adjusted basis in the property, immediately before B becomes a nonmember of the consolidated group. Accordingly, immediately before B becomes a nonmember of the consolidated group, S takes into account \$1,500 of QPAI (S's \$2,500 DPGR received from B-S's \$1,000 cost of MPGE the QPP).

(iv) *B's 2011 QPAI.* Pursuant to § 1.1502-13(d)(2)(i)(B), the attributes of B's corresponding item, that is, its sale of the QPP to U, are determined as if the S division (but not the B division) were transferred by the P, S, and B consolidated group (treated as a single corporation) to an unrelated person. Thus, S's activities in MPGE the QPP before the intercompany sale of the QPP to B continue to affect the attributes of B's sale of the QPP. As such, B is treated as having MPGE the QPP. Accordingly, upon its sale of the QPP, B has \$500 of QPAI (B's \$3,000 DPGR

**Internal Revenue Service, Treasury****§ 1.199-7**

received from U minus B's \$2,500 cost of MPGE the QPP).

*Example 11.* Corporation X is the common parent of a consolidated group, consisting of X and Y, which has filed a consolidated Federal income tax return for many years. Corporation P is the common parent of a consolidated group, consisting of P and S, which has filed a consolidated Federal income tax return for many years. The X and P consolidated groups each file their consolidated Federal income tax returns on a calendar year basis. X, Y, P and S are members of the same EAG in 2008. In 2007, the X consolidated group incurred a consolidated net operating loss (CNOL) of \$25,000, none of which was carried back and used to offset taxable income of prior taxable years. Neither P nor S (nor the P consolidated group) has ever incurred an NOL. In 2008, the X consolidated group has (prior to the deduction under section 172) taxable income of \$8,000 and the P consolidated group has taxable income of \$20,000. The X consolidated group uses \$8,000 of its CNOL from 2007 to offset the X consolidated group's taxable income in 2008. None of the X consolidated group's remaining CNOL may be used to offset taxable income of the P consolidated group under paragraph (b)(3) of this section. Accordingly, for purposes of determining the EAG's section 199 deduction, the EAG has taxable income of \$20,000 (the X consolidated group's taxable income (after the deduction under section 172) of \$0 plus the P consolidated group's taxable income of \$20,000).

(f) *Allocation of income and loss by a corporation that is a member of the expanded affiliated group for only a portion of the year—(1) In general.* A corporation that becomes or ceases to be a member of an EAG during its taxable year must allocate its taxable income or loss, QPAI, and W-2 wages between the portion of the taxable year that it is a member of the EAG and the portion of the taxable year that it is not a member of the EAG. This allocation of items is made by using the pro rata allocation method described in this paragraph (f)(1). Under the pro rata allocation method, an equal portion of a corporation's taxable income or loss, QPAI, and W-2 wages for the taxable year is assigned to each day of the corporation's taxable year. Those items assigned to those days that the corporation was a member of the EAG are then aggregated.

(2) *Coordination with rules relating to the allocation of income under § 1.1502-76(b).* If § 1.1502-76(b) (relating to items included in a consolidated return) ap-

plies to a corporation that is a member of an EAG, then any allocation of items required under this paragraph (f) is made only after the allocation of the corporation's items pursuant to § 1.1502-76(b).

(g) *Total section 199 deduction for a corporation that is a member of an expanded affiliated group for some or all of its taxable year—(1) Member of the same expanded affiliated group for the entire taxable year.* If a corporation is a member of the same EAG for its entire taxable year, the corporation's section 199 deduction for the taxable year is the amount of the section 199 deduction allocated to the corporation by the EAG under paragraph (c)(1) of this section.

(2) *Member of the expanded affiliated group for a portion of the taxable year.* If a corporation is a member of an EAG only for a portion of its taxable year and is either not a member of any EAG or is a member of another EAG, or both, for another portion of the taxable year, the corporation's section 199 deduction for the taxable year is the sum of its section 199 deductions for each portion of the taxable year.

(3) *Example.* The following example illustrates the application of paragraphs (f) and (g) of this section:

*Example.* (i) *Facts.* Corporations X and Y, calendar year corporations, are members of the same EAG for the entire 2010 taxable year. Corporation Z, also a calendar year corporation, is a member of the EAG of which X and Y are members for the first half of 2010 and not a member of any EAG for the second half of 2010. During the 2010 taxable year, neither X, Y, nor Z joins in the filing of a consolidated Federal income tax return. Assume that X, Y, and Z each has W-2 wages in excess of the section 199(b) wage limitation for all relevant periods. In 2010, X has taxable income of \$2,000 and QPAI of \$600, Y has a taxable loss of \$400 and QPAI of (\$200), and Z has taxable income of \$1,400 and QPAI of \$2,400.

(ii) *Analysis.* Pursuant to the pro rata allocation method, \$700 of Z's 2010 taxable income and \$1,200 of Z's 2010 QPAI are allocated to the first half of the 2010 taxable year (the period in which Z is a member of the EAG) and \$700 of Z's 2010 taxable income and \$1,200 of Z's 2010 QPAI are allocated to the second half of the 2010 taxable year (the period in which Z is not a member of any EAG). Accordingly, in 2010, the EAG has taxable income of \$2,300 (X's \$2,000 + Y's (\$400) + Z's \$700) and QPAI of \$1,600 (X's \$600 + Y's

## § 1.199-8

(\$200) + Z's \$1,200). The EAG's section 199 deduction for 2010 is therefore \$144 (9% of the lesser of the EAG's \$2,300 of taxable income or \$1,600 of QPAI). Pursuant to § 1.199-7(c)(1), this \$144 deduction is allocated to X, Y, and Z in proportion to their respective QPAI. Accordingly, X is allocated \$48 of the EAG's section 199 deduction, Y is allocated \$0 of the EAG's section 199 deduction, and Z is allocated \$96 of the EAG's section 199 deduction. For the second half of 2010, Z has taxable income of \$700 and QPAI of \$1,200. Therefore, for the second half of 2010, Z has a section 199 deduction of \$63 (9% of the lesser of its \$700 taxable income or \$1,200 QPAI for the second half of 2010). Accordingly, X's 2010 section 199 deduction is \$48, Y's 2010 section 199 deduction is \$0, and Z's 2010 section 199 deduction is \$159, the sum of the \$96 section 199 deduction of the EAG allocated to Z for the first half of 2010 and Z's \$63 section 199 deduction for the second half of 2010.

(h) *Computation of section 199 deduction for members of an expanded affiliated group with different taxable years—(1) In general.* If members of an EAG have different taxable years, in determining the section 199 deduction of a member (the computing member), the computing member is required to take into account the taxable income or loss, determined without regard to the section 199 deduction, QPAI, and W-2 wages of each other group member that are both—

(i) Attributable to the period that each other member of the EAG and the computing member are members of the EAG; and

(ii) Taken into account in a taxable year that begins after the effective date of section 199 and such taxable year ends with or within the taxable year of the computing member with respect to which the section 199 deduction is computed.

(2) *Example.* The following example illustrates the application of this paragraph (h):

*Example.* (i) Corporations X, Y, and Z are members of the same EAG. Neither X, Y, nor Z is a member of a consolidated group. X and Y are calendar year taxpayers and Z is a June 30 fiscal year taxpayer. Z came into existence on July 1, 2007. Each corporation has taxable income that exceeds its QPAI and has sufficient W-2 wages to avoid the limitation under section 199(b). For the taxable year ending December 31, 2007, X's QPAI is \$8,000 and Y's QPAI is (\$6,000). For its taxable year ending June 30, 2008, Z's QPAI is \$2,000.

## 26 CFR Ch. I (4-1-11 Edition)

(ii) In computing X's and Y's respective section 199 deductions for their taxable years ending December 31, 2007, X's and Y's taxable income, QPAI, and W-2 wages from their respective taxable years ending December 31, 2007, are aggregated. The EAG's QPAI for this purpose is \$2,000 (X's QPAI of \$8,000 + Y's QPAI of (\$6,000)). Because the taxable years of the computing members, X and Y, began in 2007, the transition percentage under section 199(a)(2) is 6%. Accordingly, the EAG's section 199 deduction is \$120 ( $\$2,000 \times .06$ ). The \$120 deduction is allocated to each of X and Y in proportion to their respective QPAI as a percentage of the QPAI of each member of the EAG that was taken into account in computing the EAG's section 199 deduction. Pursuant to paragraph (c)(1) of this section, in allocating the section 199 deduction between X and Y, because Y's QPAI is negative, Y's QPAI is treated as being \$0. Accordingly, X's section 199 deduction for its taxable year ending December 31, 2007, is \$120 ( $\$120 \times \$8,000 / (\$8,000 + \$0)$ ). Y's section 199 deduction for its taxable year ending December 31, 2007, is \$0 ( $\$120 \times \$0 / (\$8,000 + \$0)$ ).

(iii) In computing Z's section 199 deduction for its taxable year ending June 30, 2008, X's and Y's items from their respective taxable years ending December 31, 2007, are taken into account. Therefore, X's and Y's taxable income or loss, determined without regard to the section 199 deduction, QPAI, and W-2 wages from their taxable years ending December 31, 2007, are aggregated with Z's taxable income or loss, QPAI, and W-2 wages from its taxable year ending June 30, 2008. The EAG's QPAI is \$4,000 (X's QPAI of \$8,000 + Y's QPAI of (\$6,000) + Z's QPAI of \$2,000). Because the taxable year of the computing member, Z, began in 2007, the transition percentage under section 199(a)(2) is 6%. Accordingly, the EAG's section 199 deduction is \$240 ( $\$4,000 \times .06$ ). A portion of the \$240 deduction is allocated to Z in proportion to its QPAI as a percentage of the QPAI of each member of the EAG that was taken into account in computing the EAG's section 199 deduction. Pursuant to paragraph (c)(1) of this section, in allocating a portion of the \$240 deduction to Z, because Y's QPAI is negative, Y's QPAI is treated as being \$0. Z's section 199 deduction for its taxable year ending June 30, 2008, is \$48 ( $\$240 \times \$2,000 / (\$8,000 + \$0 + \$2,000)$ ).

[T.D. 9263, 71 FR 31283, June 1, 2006, as amended by T.D. 9293, 71 FR 61679, Oct. 19, 2006; 72 FR 6, Jan. 3, 2007; T.D. 9381, 73 FR 8813, Feb. 15, 2008; T.D. 9384, 73 FR 12271, Mar. 7, 2008]

## § 1.199-8 Other rules.

(a) *In general.* The provisions of this section apply solely for purposes of section 199 of the Internal Revenue Code (Code). When calculating the deduction