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Peter A. White,

Acting Manager, Engine and Propeller Directorate, Aircraft Certification Service.

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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 9263]

RIN 1545-BE33

Income Attributable to Domestic Production Activities; Correction

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Correcting amendment.

SUMMARY: This document contains corrections to final regulations which were published in the **Federal Register** on Thursday, June 1, 2006, (71 FR 31268), relating to the deduction for income attributable to domestic production activities under section 199 of the Internal Revenue Code (Code).

DATES: This correction is effective June 1, 2006.

FOR FURTHER INFORMATION CONTACT: Paul Handleman or Lauren Ross Taylor at (202) 622-3040 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

The final regulations (TD 9263) that are subject to this correction are under section 199 of the Internal Revenue Code.

Need for Correction

On June 1, 2006, final regulations (TD 9263) were published in the **Federal Register** at 71 FR 31268. These regulations contain errors that may prove to be misleading and are in need of clarification.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Correction of Publication

■ Accordingly, 26 CFR Part 1 is corrected by making the following correcting amendments:

PART 1—INCOME TAXES

■ **Paragraph 1.** The authority citation for part 1 continues to read, in part, as follows:

Authority: 26 U.S.C. 7805 * * *

§ 1.199-1 [Corrected]

■ **Par. 2.** Section 1.199-1(b)(1) is amended by revising the first sentence of the paragraph to read as follows:

§ 1.199-1 Income attributable to domestic production activities.

* * * * *

(b) * * *

(1) *In general.* For purposes of paragraph (a) of this section, the definition of taxable income under section 63 applies, except that taxable income (or alternative minimum taxable income, if applicable) is determined without regard to section 199 and without regard to any amount excluded from gross income pursuant to section 114 or pursuant to section 101(d) of the American Jobs Creation Act of 2004, Public Law 108-357 (118 Stat. 1418) (Act). * * *

* * * * *

§ 1.199-2 [Corrected]

■ **Par. 3.** Section 1.199-2 is amended by revising the first sentence of paragraph (a)(3)(ii) and the last sentence of paragraph (e)(3) to read as follows:

§ 1.199-2 Wage limitation.

(a) * * *

(3) * * *

(ii) *Corrected return filed to correct a return that was filed within 60 days of the due date.* If a corrected information return (Return B) is filed with SSA on or before the 60th day after the due date (including extensions) of Return B to correct an information return (Return A) that was filed with SSA on or before the 60th day after the due date (including extensions) of the information return (Return A) and paragraph (a)(3)(iii) of this section does not apply, then the wage information on Return B must be included in determining W-2 wages. * * *

* * * * *

(e) * * *

(3) * * * For example, see Rev. Proc. 2006-22 (2006-23 I.R.B. 1033). (see § 601.601(d)(2) of this chapter).

§ 1.199-3 [Corrected]

■ **Par. 4.** Section 1.199-3(l)(4)(iv)(A) is amended by revising the first sentence of the paragraph to read as follows:

§ 1.199-3 Domestic production gross receipts.

* * * * *

(l) * * *

(4) * * *

(iv) * * *

(A) * * * *DPGR.* Notwithstanding paragraphs (l)(4)(i), (ii), and (iii) of this section, if less than 5 percent of a taxpayer's gross receipts derived from a sale, exchange, or other disposition of utilities are attributable to the transmission or distribution of the utilities and the storage of potable water after completion of treatment of the potable water, then the gross receipts derived from the lease, rental, license, sale, exchange, or other disposition of the utilities that are attributable to the transmission and distribution of the utilities and the storage of potable water after completion of treatment of the potable water may be treated as being DPGR (assuming all other requirements of this section are met). * * *

* * * * *

§ 1.199-4 [Corrected]

■ **Par. 5.** Section 1.199-4(d)(6) is amended by revising paragraph (i) of *Examples 1* and *2* to read as follows:

§ 1.199-4 Costs allocable to domestic production gross receipts.

* * * * *

(d) * * *

(6) * * *

Example 1. * * *

(i) *Facts.* X, a United States corporation that is not a member of an expanded affiliated group (EAG) (as defined in § 1.199-7), engages in activities that generate both DPGR and non-DPGR. All of X's production activities that generate DPGR are within Standard Industrial Classification (SIC) Industry Group AAA (SIC AAA). All of X's production activities that generate non-DPGR are within SIC Industry Group BBB (SIC BBB). X is able to specifically identify CGS allocable to DPGR and to non-DPGR. X incurs \$900 of research and experimentation expenses (R&E) that are deductible under section 174, \$300 of which are performed with respect to SIC AAA and \$600 of which are performed with respect to SIC BBB. None of the R&E is legally mandated R&E as described in § 1.861-17(a)(4) and none of the R&E is included in CGS. X incurs section 162 selling expenses that are not includible in CGS and are definitely related to all of X's gross income. For 2010, the adjusted basis of X's assets is \$5,000, \$4,000 of which generates gross income attributable to DPGR and \$1,000 of which generates gross income attributable to non-DPGR. For 2010, X's taxable income is \$1,380 based on the following Federal income tax items: * * *

* * * * *

Example 2. * * *

(i) *Facts.* The facts are the same as in *Example 1* except that X owns stock in Y, a United States corporation, equal to 75% of the total voting power of stock of Y and 80% of the total value of stock in Y. X and Y are

not members of an affiliated group as defined in section 1504(a). Accordingly, the rules of § 1.861-14T do not apply to X's and Y's selling expenses, R&E, and charitable contributions. X and Y are, however, members of an affiliated group for purposes of allocating and apportioning interest expense (see § 1.861-11T(d)(6)) and are also members of an EAG. For 2010, the adjusted basis of Y's assets is \$45,000, \$21,000 of which generates gross income attributable to DPGR and \$24,000 of which generates gross income attributable to non-DPGR. All of Y's activities that generate DPGR are within SIC Industry Group AAA (SIC AAA). All of Y's activities that generate non-DPGR are within SIC Industry Group BBB (SIC BBB). None of X's and Y's sales are to each other. Y is not able to specifically identify CGS allocable to DPGR and non-DPGR. In this case, because CGS is definitely related under the facts and circumstances to all of Y's gross receipts, apportionment of CGS between DPGR and non-DPGR based on gross receipts is appropriate. For 2010, Y's taxable income is \$1,910 based on the following Federal income tax items: * * *

* * *

§ 1.199-6 [Corrected]

■ **Par. 6.** Section 1.199-6 is amended as follows:

■ 1. The last sentence of paragraph (g), is revised.

■ 2. The last sentence of *Example 2* (i) in paragraph (m) is revised.

The revisions read as follows:

§ 1.199-6 Agricultural and horticultural cooperatives.

* * *

(g) *Written notice to patrons.* * * *
The cooperative must report the amount of the patron's section 199 deduction on Form 1099-PATR, "Taxable Distributions Received From Cooperatives," issued to the patron.

* * *

(m) * * *

Example 2. (i) * * * Cooperative X must report the amount of Patron A's section 199 deduction on Form 1099-PATR, "Taxable Distributions Received From Cooperatives," issued to Patron A for the calendar year 2008.

* * *

§ 1.199-7 [Corrected]

■ **Par. 7.** Section 1.199-7 is amended as follows:

■ 1. *Example 3* in paragraph (a)(4) is revised.

■ 2. *Example 10* in paragraph (e) is revised.

The revisions read as follows:

§ 1.199-7 Expanded affiliated groups.

(a) * * *

(4) * * *

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.

* * *

(e) * * *

Example 10. (i) *Facts.* Corporation P owns all of the stock of Corporations S and T, and P, S, and T file a consolidated Federal income tax return on a calendar year basis. In 2007, P MPGE QPP in the United States at a cost of \$1,000. On November 30, 2007, P sells the QPP to S for \$2,500. On February 28, 2008, P disposes of 60% of the stock of S. On June 30, 2008, S sells the QPP to an unrelated person for \$3,000.

* * *

§ 1.199-8 [Corrected]

■ **Par. 8.** Section 1.199-8 is amended by revising paragraph (h) to read as follows:

§ 1.199-8 Other rules.

* * *

(h) *Disallowed losses or deductions.*
Except as provided by publication in the Internal Revenue Bulletin (see § 601.601(d)(2)(ii)(b) of this chapter), losses or deductions of a taxpayer that otherwise would be taken into account in computing the taxpayer's section 199 deduction are taken into account only if and to the extent the deductions are not disallowed by section 465 or 469, or any other provision of the Code. If only a portion of the taxpayer's share of the losses or deductions is allowed for a taxable year, the proportionate share of those allowable losses or deductions that are allocated to the taxpayer's qualified production activities, determined in a manner consistent with sections 465 and 469, and any other applicable provision of the Code, is taken into account in computing QPAI for purposes of the section 199 deduction for that taxable year. To the extent that any of the disallowed losses or deductions are allowed in a later

year, the taxpayer takes into account a proportionate share of those losses or deductions in computing its QPAI for that later taxable year. Losses or deductions of the taxpayer that are disallowed for taxable years beginning on or before December 31, 2004, are not taken into account in a later year for purposes of computing the taxpayer's QPAI and the wage limitation of section 199(d)(1)(A)(iii) under § 1.199-9 for that taxable year, regardless of whether the losses or deductions are allowed for other purposes. For taxpayers that are partners in partnerships, see § 1.199-9(b)(2). For taxpayers that are shareholders in S corporations, see § 1.199-9(c)(2).

* * *

§ 1.199-9 [Corrected]

■ **Par. 9.** Section 1.199-9(b)(6) is amended as follows:

■ 1. By revising *Example 1* paragraphs (i), (iii)(B)(1), and the seventh sentence of (iii)(B)(2).

■ 2. By revising *Example 2* paragraphs (i), and (iii)(B)(1), and the table following (iii)(B)(3).

■ 3. Paragraph (h) is revised.

The revisions read as follows:

§ 1.199-9 Application of section 199 to pass-thru entities for taxable years beginning on or before May 17, 2006, the enactment date of the Tax Increase Prevention and Reconciliation Act of 2005.

* * *

(b) * * *

(6) * * *

Example 1. * * * (i) *Partnership Federal income tax items.* X and Y, unrelated United States corporations, are each 50% partners in PRS, a partnership that engages in production activities that generate both DPGR and non-DPGR. X and Y share all items of income, gain, loss, deduction, and credit 50% each. Both X and Y are engaged in a trade or business. PRS is not able to specifically identify CGS allocable to DPGR and non-DPGR. In this case, because CGS is definitely related under the facts and circumstances to all of PRS's gross income, apportionment of CGS between DPGR and non-DPGR based on gross receipts is appropriate. For 2006, the adjusted basis of PRS's business assets is \$5,000, \$4,000 of which generate gross income attributable to DPGR and \$1,000 of which generate gross income attributable to non-DPGR. For 2006, PRS has the following Federal income items:

* * *

(iii) * * *

(B) * * * (1) For 2006, in addition to the activities of PRS, Y engages in production activities that generate both DPGR and non-DPGR. Y is able to specifically identify CGS allocable to DPGR and to non-DPGR. For 2006, the adjusted basis of Y's non-PRS assets attributable to its production activities that generate DPGR is \$8,000 and to other

production activities that generate non-DPGR is \$2,000. Y has no other assets. Y has the following Federal income tax items relating to its non-PRS activities: * * *

(2) * * * Y has \$1,290 of gross income attributable to DPGR (\$3,000 DPGR (\$1,500 from PRS and \$1,500 from non-PRS activities)—\$1,710 CGS (\$810 from PRS and \$900 from non-PRS activities)). * * *

* * * * *

Example 2. * * * (i) *Partnership items of income, gain, loss, deduction or credit.* X and Y, unrelated United States corporations each of which is engaged in a trade or business, are partners in PRS, a partnership that engages in production activities that generate both DPGR and non-DPGR. Neither X nor Y is a member of an affiliated group. X and Y share all items of income, gain, loss, deduction, and credit 50% each. All of PRS's domestic production activities that generate DPGR are within Standard Industrial

Classification (SIC) Industry Group AAA (SIC AAA). All of PRS's production activities that generate non-DPGR are within SIC Industry Group BBB (SIC BBB). PRS is not able to specifically identify CGS allocable to DPGR and to non-DPGR and, therefore, apportions CGS to DPGR and non-DPGR based on its gross receipts. PRS incurs \$900 of research and experimentation expenses (R&E) that are deductible under section 174, \$300 of which are performed with respect to SIC AAA and \$600 of which are performed with respect to SIC BBB. None of the R&E is legally mandated R&E as described in § 1.861-17(a)(4) and none is included in CGS. PRS incurs section 162 selling expenses (that include W-2 wage expense) that are not includible in CGS and are definitely related to all of PRS's gross income. For 2006, PRS has the following Federal income tax items:

* * * * *

(iii) * * *

(B) * * * (1) For 2006, in addition to the activities of PRS, Y engages in domestic production activities that generate both DPGR and non-DPGR. With respect to those non-PRS activities, Y is not able to specifically identify CGS allocable to DPGR and to non-DPGR. In this case, because CGS is definitely related under the facts and circumstances to all of Y's non-PRS gross receipts, apportionment of CGS between DPGR and non-DPGR based on Y's non-PRS gross receipts is appropriate. For 2006, Y has the following non-PRS Federal income tax items: * * *

* * * * *

(3) * * *

DPGR (\$4,500 DPGR (\$1,500 from PRS and \$3,000 from non-PRS activities))	\$4,500
CGS (\$600 from sales of products by PRS and \$1,500 from non-PRS activities)	(2,100)
Section 162 selling expenses (including W-2 wages) (\$420 from PRS + \$540 from non-PRS activities) x (\$4,500 DPGR/ \$9,000 total gross receipts)	(480)
Section 174 R&E-SIC AAA (\$150 from PRS and \$300 from non-PRS activities)	(450)
Section 174 R&E-SIC BBB (\$300 from PRS + \$450 from non-PRS activities) x (\$1,500 DPGR/\$6,000 total gross receipts allocated to SIC BBB (\$1,500 from PRS and \$4,500 from non-PRS activities))	(188)
Y's QPAI	1,282

* * * * *

(h) * * * Except as provided in paragraph (i) of this section regarding qualifying in-kind partnerships and paragraph (j) of this section regarding EAG partnerships, an owner of a pass-thru entity is not treated as conducting the qualified production activities of the pass-thru entity, and vice versa. This rule applies to all partnerships, including partnerships that have elected out of subchapter K under section 761(a). Accordingly, if a partnership MPGE QPP within the United States, or produces a qualified film or produces utilities in the United States, and distributes or leases, rents, licenses, sells, exchanges, or otherwise disposes of such property to a partner who then, without performing its own qualifying MPGE or other production, leases, rents, licenses, sells, exchanges, or otherwise disposes of such property, then the partner's gross receipts from this latter lease, rental, license, sale, exchange, or other disposition are treated as non-DPGR. In addition, if a partner MPGE QPP within the United States, or produces a qualified film or produces utilities in the United States, and contributes or leases, rents, licenses, sells, exchanges, or otherwise disposes of such property to a partnership which then, without performing its own qualifying MPGE or other production, leases, rents, licenses, sells, exchanges, or otherwise disposes of such property,

then the partnership's gross receipts from this latter disposition are treated as non-DPGR.

* * * * *

Guy R. Traynor,

Federal Register Liaison, Legal Processing Division, Associate Chief Counsel (Procedure & Administration).

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DEPARTMENT OF LABOR

Occupational Safety and Health Administration

29 CFR Part 1915

[Docket No. S-051A]

RIN 1218-AC16

Updating National Consensus Standards in OSHA's Standard for Fire Protection in Shipyard Employment

AGENCY: Occupational Safety and Health Administration (OSHA), Department of Labor.

ACTION: Final rule; confirmation of effective date.

SUMMARY: OSHA is confirming the effective date of its direct final rule for shipyards that incorporated by reference 19 National Fire Protection Association (NFPA) standards. The direct final rule

stated that it would become effective on January 16, 2007 unless significant adverse comment was received by November 16, 2006. No adverse comments were received. Therefore, the rule will become effective on January 16, 2007.

DATES: The direct final rule published on October 17, 2006 (71 FR 60843) is effective January 16, 2007. For the purpose of judicial review, OSHA considers January 3, 2007 as the date of issuance.

FOR FURTHER INFORMATION CONTACT:

Press Inquiries: Kevin Ropp, OSHA Office of Communications, Room N-3647, U.S. Department of Labor, 200 Constitution Avenue, NW., Washington, DC 20210; telephone: (202) 693-1999. *General and technical information:* Jim Maddux, Director, Office of Maritime, Directorate of Standards and Guidance, Occupational Safety and Health Administration, U.S. Department of Labor, Room N-3609, 200 Constitution Avenue, NW., Washington, DC 20210; telephone (202) 693-1968.

ADDRESSES: In compliance with 28 U.S.C. 2112(a), OSHA designates the Associate Solicitor for Occupational Safety and Health as the recipient of petitions for review of the final standard. The Associate Solicitor may be contacted at the Office of the Solicitor, Room S-4004, U.S. Department of Labor, 200 Constitution