David Chavern
President and Chief Executive Officer

November 25, 2015

CC:PA:LPD:PR (REG-136459-09), Room 5203
Internal Revenue Service
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

Re: Comments on Proposed REG-136459-09, Amendments to Domestic Production Deduction Regulations

Dear Mr. Jenner:

In connection with the request for comments made by the Department of the Treasury (the "Treasury") and the Internal Revenue Service (the "IRS") in Notice of Proposed Rulemaking dated August 27, 2015 (Proposed REG-136459-09), regarding Proposed Treasury Regulations (the "Proposed Regulations") under Section 199 of the Internal Revenue Code of 1986, as amended (the "Code"), I would like to submit the following comments for your consideration as you prepare the final regulations (the "Final Regulations"). The Newspaper Association of America (NAA) is a nonprofit organization representing nearly 2,000 newspapers accounting for nearly 90 percent of the daily print circulation in the United States. While most NAA members are dailies, many weekly newspapers are also members. In addition, most newspapers currently own and operate online newspapers and other digital products. The newspaper industry employs more than 200,000 workers in the United States.

I. Executive Summary

A. The NAA does not believe that the proposed default rule that would extend the section 199 deduction only to unrelated contract printers would be a valid exercise of regulatory authority under section 199 in the case of many cost reimbursable contracts. In order to claim the deduction, section 199 requires that the taxpayer sell or otherwise dispose of qualified production property. In the case of contract printers operating under many cost reimbursable contracts, they would not be treated as the owner of the printed newspapers for income tax purposes and therefore could not sell or otherwise dispose of the newspapers.

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B. If the proposed default rule is included in the Final Regulations, the NAA recommends that in respect of certain cost reimbursable contracts, where the newspaper publisher pays for 75% or more of the tangible personal property that is consumed in the manufacturing process, the newspaper publisher should be treated as conducting the manufacturing activity. In order to minimize the risk of more than one taxpayer claiming the section 199 deduction, the exception could apply only if the written contract expressly provides that solely the newspaper publisher can claim the section 199 deduction. This exception is appropriate since the newspaper publisher would be the tax owner of the newspapers throughout the manufacturing process and without the newspaper publisher creating the content for the newspaper and hiring the contract printer, there would be no manufacturing of newspapers.

C. If Treasury and the IRS would prefer a simpler rule, the NAA recommends that the Final Regulations adopt a special rule for newspapers, magazines, and other periodicals providing that in cases in which the publisher provides the contract printer with the newsprint or other paper used to print the printed work, only the publisher is entitled to claim the section 199 deduction.

D. The NAA recommends that the Final Regulations include an example in which advertising revenues received by a newspaper for inserting advertising inserts into a newspaper are treated as domestic production gross receipts ("DPGR"). The advertising inserts are part of the "item" that is the newspaper that is sold to customers, and the advertising revenue for inserts is "inextricably linked" to the gross receipts derived from the sale or other disposition of the newspapers.

E. The NAA urges Treasury and the IRS to extend the benefits of the section 199 deduction to online and digital newspapers. There is no economic reason to make the distinction between advertising income and subscription fees for a tangible newspaper versus an online or digital newspaper. Alternatively, if Treasury and the IRS believe it is necessary for such a change to be effected by statute, the NAA and its members hope that Treasury and the IRS will support an amendment to section 199 to permit the manufacturing deduction to be claimed in respect of advertising income and subscription fees for online and digital newspapers.

II. The Section 199 Deduction

As you are aware, section 199 is specifically designed to benefit United States manufacturers with a deduction that is equal to a portion of the taxpayer's "qualified production activities income." The deduction currently is equal to 9% of the lesser of (i) the qualified production activities income, or (ii) taxable income (determined without regard to the provision) for the taxable year. The deduction is limited to 50% of an employer's W-2 wages for the taxable year.

Qualified production activities income is equal to the "domestic production gross receipts" reduced by the sum of certain costs allocable to such receipts. Section 199(c)(1). Domestic production gross receipts include "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 . . ." ("DPGR"). Section 199(c)(4)(A)(I). The term

"qualifying production property" includes "tangible personal property" ("QPP"). Section 199(c)(5)(A).

III. How the Treatment of Newspapers Under Section 199 has Evolved

A newspaper publisher that produces and prints its own newspapers is engaged in producing and manufacturing tangible personal property within the meaning of section 199. The manufacturing process typically starts with newspaper reporters gathering information and preparing news reports and other content. Advertisements are also prepared and made ready for printing. Using special machinery and computers, the news, advertisements and other content is converted into a printed product. The final stage typically involves skilled employees operating large and expensive machinery (presses) to convert the raw materials of rolls of blank paper stock (newsprint), ink, and the newspaper content (news stories, advertising and other information) into a tangible product—a newspaper. The newspapers are then sold or otherwise distributed to the newspaper's customers, its readers.

Immediately following the enactment of section 199, it was clear that subscription and other revenue earned from readers who purchased newspapers and other printed publications could qualify as DPGR, as such publications fall within the definition of tangible personal property. But it was not then clear that the same would hold for receipts paid by advertisers.

In response to a comment letter NAA submitted to the Treasury, dated November 23, 2004, the IRS included in Notice 2005-14, 2005-7 I.R.B. 498, a provision that treated advertising receipts attributable to the sale or other disposition of newspapers and magazines as DPGR. The Notice explained that advertising receipts in this context should be considered "derived from" the sale or other disposition of newspapers and magazines because the advertising income is "inextricably linked" to the gross receipts derived from the lease, rental, license, sale, exchange, or other disposition of the newspapers and magazines. *Id.*, section 3.04(7)(c). This approach was appropriate, as but for the receipt of advertising income from display and classified advertisements, newspapers and magazines would not be manufactured or produced.

Proposed regulations under section 199 issued in 2005 (REG-105847-05) (the "2005 Proposed Regulations") carried over Notice 2005-14's treatment of advertising receipts for newspaper (and magazine) advertising as DPGR. In addition, the 2005 Proposed Regulations extended this treatment of advertising receipts to advertising in telephone directories and periodicals. 2005 Prop. Reg. section 1.199-3(h)(5)(i).

While it appeared that the 2005 Proposed Regulations intended for advertising receipts from the distribution of newspapers and magazines free of charge should be treated as DPGR, that point was not perfectly clear in the 2005 Proposed Regulations. The final Regulations (T.D. 9623) issued on May 24, 2006 (the "2006 Final Regulations), with a small change in wording, clarified that advertising revenue from such free-circulation newspapers and magazines is DPGR. 2006 Final Regulations section 1.199-3(i)(5)(i); *see also* Preamble to T.D. 9623 ("the final regulations clarify that there need be no gross receipts attributable to the disposition of the printed materials . . . for the gross receipts from the advertising to qualify as DPGR"). In addition, the 2006 Final Regulations included two newspaper examples where DPGR is created, one a newspaper that

generates both circulation revenue and advertising revenue, and the second where only advertising income from a free-circulation newspaper is generated. 2006 Final Regulations 1.199-3(i)(5)(iii), Examples 1 and 2.

This last change was appropriate, as free-circulation newspapers and magazines present a clear case for inclusion under the Section 199 umbrella. Many free-circulation newspapers and magazines contain primarily advertising and little or no editorial content. Other free-circulation newspapers contain both editorial content and advertising. When a newspaper or other publication with advertising placed in it is distributed for free, there is a transfer (i.e., a disposition) of the publication to the reader, but there is no sale of a newspaper or other publication to a reader and therefore no circulation revenue is generated. Instead, the owner of the newspaper or other publication receives only advertising receipts from advertisers. In effect, the advertisers pay for the newspaper or other publication to be manufactured and distributed for free to readers.

The current treatment under Section 199 of advertising inserts into newspapers and online and digital products will be addressed below where those topics are discussed in detail.

IV. The Proposed Default Rule for Contract Manufacturing Would not be Valid Under the Applicable Statutes; in the Alternative, an Exception Should be Made for Certain Cost Reimbursable Contracts

Consistent with Section 199(d)(10), under the current 2006 Final Regulations, only one taxpayer may claim the section 199 domestic production activities deduction regarding a qualifying manufacturing or other activity. 2006 Final Regulations section 1.199-3(f)(1). The Proposed Regulations would not alter this rule. Under the 2006 Final Regulations, the taxpayer with the benefits and burdens of ownership of the QPP during the period in which the qualifying activity is performed is treated as engaging in the qualifying activity and is therefore entitled to the deduction. 2006 Final Regulations section 1.199-3(f)(1). The Proposed Regulations would eliminate this "benefits and burdens" rule and in its place assign the deduction to the party that performs the manufacturing or other qualifying activity. Proposed Regulations sections 1.199(f)(1) and 1.199(g)(4)(i); *see also* Proposed Regulations section 1.199-3(e)(1)("the taxpayer must be the party engaged in the [manufacturing or production] of the QPP during the period that the [manufacturing or production] activity occurs in order for gross receipts derived from [such manufacturing or production] of QPP to qualify as DPGR"). In most contract manufacturing cases, this new rule would result in the unrelated contract manufacturer claiming the section 199 deduction, whether or not it or its customer had the benefits and burdens of ownership during production.

In the preamble to the Proposed Regulations, the Treasury and IRS justify the change in rule as follows: "To provide administrable rules that are consistent with section 199, reduce the burden on taxpayers and the IRS in evaluating factors related to the benefits and burdens of ownership, and prevent more than one taxpayer from being allowed a deduction under section 199 with respect to any qualifying activity . . . ." The preamble added as another justification, "This rule . . . reflects the conclusion that the party actually producing the property should be treated as

engaging in the qualifying activity for purposes of section 199, and is therefore consistent with the statute's goal of incentivizing domestic manufacturers and producers."

In the newspaper industry, contract manufacturing is not uncommon. For example, newspapers that are nationally distributed typically do not own and operate printing plants in all regions of the country and therefore contract with unrelated commercial printers to print their newspapers. While the arrangements differ, a frequent approach is that the newspaper company purchases and provides the newsprint to the contract printer. The cost of the newsprint is typically about 85% of the cost of the raw materials that are consumed in the manufacturing process (ink and water are two other items of raw materials consumed in the manufacturing process). Accordingly, the newsprint on which the newspaper is printed is owned by the newspaper publisher. In this arrangement, the newspaper publisher simply views the contract printer as providing a service. Indeed, the contract printer is not selling a manufactured product to the newspaper publisher, since the contract printer does not own the product. We believe that it would be inappropriate for the contract printer to be permitted to claim the section 199 deduction in this circumstance.

The fact that the contract printer in the circumstances noted above is merely performing a service is reflected by the price paid by the newspaper publisher to the contact printer for the printing service, which typically would be only a small fraction of the overall price paid by the customer to the newspaper publisher as a subscription fee. Under the Proposed Regulations, it would also appear that no party would be entitled to claim advertising revenue paid by advertisers for display and classified advertising incorporated in the newspapers. The contract printer would not be entitled to claim the advertising revenue in its DPGR since it would not receive the revenue, and the newspaper publisher may not be entitled to claim the advertising revenue in its DPGR because it would not be treated as engaging in the manufacturing or production activity. In addition, newspaper publishers, unlike most other manufacturers, help to manufacture their product on a daily basis, by their employees converting words and images into news articles and other content. The fact that the contract printing service fee bears no relation to the cost or sales price of the newspaper, that no party in this context can claim the advertising revenue as DPGR, and that the newspaper publisher's daily role in producing newspapers would be disregarded demonstrates how inappropriate this new default rule would be for newspaper publishers.

A regulation that is "plainly inconsistent" with the language of the governing statute is invalid as an improper exercise of the power delegated the Secretary by Congress. *See United States v. Cartwright*, 411 U.S. 546, 557 (1973); *Commissioner v. South Texas Lumber Co.*, 333 U.S. 496, 501 (1948). Code section 199(a) provides that "There shall be allowed as a deduction an amount equal to 9 percent of the lesser of (1) the qualified production activities income of the taxpayer for the taxable year, or (2) taxable income (determined without regard to this section) for the taxable year. Pursuant to Code section 199(c)(1)(A), the term "qualified production activities income is based on DPGR. Pursuant to Code section 199(c)(4)(A), DPGR means "the gross receipts of the taxpayer which are derived from—(i) any lease, rental, license, sale, exchange, or other disposition of" QPP. The contract printer in many cases cannot sell or otherwise dispose of the newspapers to the newspaper publisher because the contract printer does not own the newspapers for income tax purposes. Accordingly, the NAA does not believe that having as a default rule allowing the contract printer to claim the section 199 deduction in these

circumstances in the Final Regulations would be valid under the statutory language in section 199 quoted in this paragraph.

Correctly recognizing the potentially inappropriate effects of its new default approach, in the preamble to the Proposed Regulations, the Treasury and IRS:

> . . . request comments on whether there are narrow circumstances that could justify an exception to the proposed rule. In particular, the Treasury Department and the IRS request comments on whether there should be a limited exception to the proposed rule for certain fully cost-plus or cost-reimbursable contracts. Under such an exception, the party that is not performing the qualifying activity would be treated as the taxpayer engaged in the qualifying activity if the party performing the qualifying activity is (i) reimbursed for, or provided with, all materials, labor, and overhead costs related to fulfilling the contract, and (ii) provided with an additional payment to allow for a profit. The Treasury Department and the IRS are uncertain regarding the extent to which such fully cost-plus or cost-reimbursable contracts are in fact used in practice. Comments suggesting circumstances that could justify an exception to the proposed rule should address the rationale for the proposed exception, the ability of the IRS to administer the exception, and how the suggested exception will prevent two taxpayers from claiming the deduction for the qualifying activity.

In the event Treasury and the IRS continue with the new default rule in the Final Regulations, the NAA believes that in respect of cost-plus, cost-reimbursable, and similar contracts, where the newspaper publisher is paying for 75% or more of the raw materials that is consumed in the manufacturing process, the newspaper publisher should be treated as conducting the manufacturing activity. The NAA recommends that the Final Regulations contain such an exception to the new default rule.

The NAA appreciates the IRS's concern about the risk of more than one taxpayer claiming the section 199 deduction. To address this concern, the NAA recommends that in order for this exception to the new default rule to apply, a written printing contract would be required to provide that only the newspaper publisher would be entitled to claim the section 199 deduction and that the unrelated contract printer would not be entitled to claim the section 199 deduction. In addition, the contract printer would be required in the written printing contract to supply the newspaper publisher with its costs related to tangible property that is consumed in the manufacturing process. The newspaper publisher, in combination with the information in its possession, could then certify on its federal income tax return that it paid for 75% or more of the raw materials used in the manufacturing process.

The NAA believes that the exception described in the above two paragraphs is appropriate because it is the newspaper publisher that purchased the newsprint and therefore is the owner of the product that is both manufactured and sold to its customers. In such an arrangement, the contract printer is merely providing a service. It is the activity of the newspaper publisher, in gathering and preparing the content for the newspapers, in paying for the bulk of the materials that are consumed in the manufacturing process, and in selling the printed newspapers to

customers that is driving the manufacturing activity. Without the newspaper publisher, there would be no manufacturing of newspapers.

The NAA believes that the IRS can easily administer the exception, since it would be required that the exception could only apply if the newspaper publisher and unrelated contract printer agree in a written contract that only the newspaper publisher would be entitled to the deduction and that the contract printer is not entitled to the deduction. In this circumstance, it is very unlikely that contract printers would intentionally seek to claim the deduction under section 199 on their income tax returns.

Requiring in the printed contract that the unrelated contract printer provide the newspaper publisher with the information needed to establish the cost of the tangible personal property materials consumed in the manufacturing process would also assist IRS auditors in auditing compliance. In most cases, the newspaper publisher would easily meet the 75% threshold.

The Final Regulations could also provide that if the printing contract provides that the printer is not entitled to claim the section 199 deduction, and the newspaper publisher for some reason cannot establish that it meets the 75% threshold, that the contract printer still could not claim the section 199 deduction. In this way, there could not be any "double dipping," and there may be some instances in which neither party to the manufacturing contract would be entitled to claim the section 199 deduction.[1]

If Treasury and the IRS would prefer a simpler rule, the NAA recommends that the Final Regulations adopt a special rule for newspapers, magazines, and other periodicals providing that in cases in which the publisher provides the contract printer with the newsprint or other paper used to print the printed work, only the publisher is entitled to claim the section 199 deduction. The NAA believes such an exception to the default rules would be appropriate for two reasons. First, it is the publisher that converts words and other content into the printed product on a daily, weekly or other periodic basis. This fact distinguishes publishers from other types of manufacturers. Second, the cost of the newsprint or other paper used to print the printed work is by far the bulk of the cost of the raw materials used. Such a clear rule would avoid the risk of more than one taxpayer claiming the section 199 deduction, and because the rule would apply only in cases where the publisher provides the newsprint or other printed products to the contract printer, the rule is easily administered.

V. The Final Regulations Should Include an Example in Which Advertising Revenues Received in Respect of Advertising Inserts are Treated as DPGR

While not raised as in issue in the Proposed Regulations, we urge the Treasury and IRS to add to the Final Regulations an example along the following lines: advertising inserts manufactured by an unrelated contract printer are inserted into newspapers that in turn a newspaper publisher manufactures and sells to its customers as a single item. The advertiser pays the newspaper

[1] Treasury and the IRS could permit the manufacturer to claim the section 199 deduction in the case where the customer does not meet the 75% threshold, if the customer certifies to the manufacturer and on its income tax return that it cannot and will not claim the section 199 deduction.

publisher for including the insert in its newspaper. The example would conclude that both the sale proceeds attributable to the advertising flyers and revenue received from the advertiser would be included in DPGR, even if there is no exception made in the Final Regulations for cost-plus or cost-reimbursable contracts.

Advertising inserts are an important part of newspapers. Typically, the advertiser, such as Walmart or Macy's, pays for the manufacturing of the insert; in this case, typically, the newspaper publisher does not pay for the paper on which the advertising inserts are printed and does not enter into cost-reimbursable or cost-plus arrangements with contract printers in respect of advertising inserts. Instead, typically the advertiser causes the advertising inserts to be manufactured by unrelated contract printers and then pays for the newspaper publisher to insert the advertising inserts (typically using specially-designed machines) inside its newspapers, which are then distributed to readers.

The 2005 Proposed Regulations contained an example in which revenue received by a newspaper publisher for distributing pre-printed advertising inserts was not treated as DPGR because the newspaper publisher did not manufacture or produce the advertising inserts that it distributed. 2005 Proposed Regulations section 1.199-3(h)(5)(iii), Example 2.[2] This example was deleted from the 2006 Final Regulations, which suggests that such income can now qualify as DPGR. The IRS presumably determined that a newspaper is a single item of property that includes any inserted advertising flyers. After all, the 2006 Final Regulations determine DPGR on an item-by-item basis, which is defined as "property offered by the taxpayer in the normal course of the taxpayer's business . . . to customers, if the gross receipts from such property qualify as DPGR." 2006 Final Regulations section 1.199-3(d)(1)(i). Here, under this test, the "item" distributed to the customer would be the entire newspaper, including any inserts, the sale of which should qualify as generating DPGR.

Example 3 of section 1.199-3(d)(4) provides that R manufactures toy cars in the United States. R also purchases cars that were manufactured by unrelated persons. R offers the cars for sale to customers, in the normal course of R's business, in sets of three. R sells the three-car sets to toy stores. A three-car set may contain some cars manufactured by R and some cars purchased by R. If the gross receipts derived from the sale of the three-car sets qualify as DPGR under section 1.199-3(d)(1)(i), then the item is the three-car set. Here, newspapers offer their entire newspapers, with the advertising inserts, to customers in the normal course of business, and advertising and subscription gross receipts derived from the sale of the newspapers should qualify as DPGR.

The example in the Proposed Regulations addressing the assembly of gift baskets is not relevant to this example. *See* Proposed Regulations 1.199-3(e)(5), Example 9. In that example, it was determined that the minor assembly and packaging of gift baskets did not constitute the

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[2] This Example 2 did not discuss whether the *de minimis* rule could have applied in this context, but presumably in theory the *de minimis* rule could have applied. Under this rule, in general, all of a taxpayer's gross receipts from the sale of each item of QPP may be treated as DPGR if less than 5% of the taxpayer's total gross receipts from the sale of each item of QPP are derived from non-DPGR. This rule is now in 2006 Final Regulations section 1.199-3(i)(4)(i)(B)(6).

manufacture or production of QPP. In the example we recommend here for advertising inserts, by contrast, the newspaper would be QPP.

The question that the example recommended by NAA poses that is different is whether the advertising revenue should be included in DPGR. 2006 Final Regulations section 1.199-3(i)(5)(i) provides in part:

> A taxpayer's gross receipts that are derived from the lease, rental, license, sale, exchange, or other disposition of newspapers, magazines, telephone directories, periodicals, and other similar printed publications that are [manufactured or produced] in whole or in significant part within the United States include advertising income from advertisements placed in those media, but only if the gross receipts, if any, derived from the lease, rental, license, sale, exchange, or other disposition of the newspapers, magazines, telephone directories, or periodicals are (or would be) DPGR.

It would appear that advertising inserts physically placed inside newspapers would qualify as DPGR under this definition.

As with advertising revenue in respect of advertising incorporated in printed newspapers, such revenue should be included in DPGR. Notice 2005-14 stated that advertising receipts attributable to the sale or other disposition of newspapers should be treated as DPGR since the advertising receipts are "inextricably linked" to the gross receipts derived from the lease, rental, license, sale, exchange, or other disposition of the newspapers. *Id.*, section 3.04(7)(c). In addition, the 2006 Final Regulations make it clear that advertising revenue related to free-circulation newspapers is DPGR. 2006 Final Regulations section 1.199-3(i)(5)(i); 2006 Final Regulations 1.199-3(i)(5)(iii), Examples 1 and 2. In Examples 1 and 2, the advertising revenue was for display or classified advertisements that the newspaper publisher included in its manufactured newspaper and were part of the newspaper.

Here, the revenue from the advertisers is for the advertising inserts being physically placed inside the newspaper. However, as in the case of advertising that is manufactured as part of the newspaper, the advertising revenue for inserts is "inextricably linked" to the gross receipts derived from the lease, rental, license, sale, exchange, or other disposition of the newspapers. The advertising inserts are part of the "item" that is the newspaper, and therefore the revenue for the advertising inserts would not have been earned but for the manufacture of the newspaper and distribution of it to readers.

VI. The Section 199 Deduction Should be Extended to Digital Newspapers

Most newspapers own and operate websites and mobile news apps to provide consumers with news and information when, where, and how they want it. Distribution over digital and mobile platforms has become more important for newspaper publishers, as the industry continues to experience declines in print circulation. Newspaper publishers spend significant resources developing these digital and mobile news distribution channels providing on-demand journalism to the public.

The migration of customers to digital consumption of news is increasing. According to the American Press Institute, digital readership has grown to a staggering 176 million adult unique users in 2015.[3] Looking ahead, the next generation of readers is embracing news content over mobile platforms at an even faster pace. According to a study released by API/Associated Press/NORC at the University of Chicago, 39 percent of millenials are more likely to read a newspaper on a mobile device than any other age group.

Since 2008 alone, print advertising revenues in newspaper has decreased by 55 percent. In response to this structural change in the way newspaper journalism is supported, newspapers have changed their business models by—among other things—offering digital-only subscriptions. Nearly all of the 1,331 daily newspapers offer digital subscriptions that fund the journalism they provide in their local market. Consumers are embracing the investments newspapers have made in journalism distributed through digital and mobile platforms by paying for digital-only or print / digital subscription packages. For example, the New York Times has more than 1 million digital-only subscribers. Regional and local publishers are transitioning as well The Boston Globe has sold more than 65,000 digital-only subscriptions.[4] Newspapers delivering content over digital and mobile platforms are generating income through subscription and advertising revenue that directly supports newspapers and their employees in local communities. Traditionally, before the Internet became such an important part of our lives, 80 percent of a newspaper's revenues derived from advertising and 20 percent derived from subscription fees. With the increasing importance of digital newspapers, today approximately 62 percent of a newspaper's revenue derives from advertising, and 30 percent derives from subscription fees, and 8 percent from other (events, digital marketing, etc.).

In preparing the 2005 Proposed Regulations, the question arose as to whether the inclusion in section 199(c)(5) of computer software as QPP would cover online newspapers and magazines. The 2005 Proposed Regulations contained two examples concluding that subscription fees and advertising revenue from online newspapers and periodicals were non-DPGR, on the ground that there was no lease, rental, license, sale, exchange, or other disposition of property and that the provision of such information was a service. 2005 Proposed Regulations section 1.199-3(h)(6)(ii), Examples 1 and 2. These examples were excluded in the 2006 Final Regulations, probably because online newspapers are controlled in those regulations by the larger treatment of computer software and online access to information. The 2006 Final Regulations provide that DPGR includes gross receipts from the lease, rental, license, sale, exchange or other disposition of computer software. Section 1.199-3(i)(6)(i). In addition, the 2006 Final Regulations restated the position in the 2005 Proposed Regulations that DPGR derived from computer software generally does not include gross receipts derived from "online services (such as Internet access services . . . providing access to online electronic books, newspapers, and journals) . . . ." Section 1.199-3(i)(6)(ii). Today, most all digital newspapers would be considered an online access service.

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[3] *See:* http://www.americanpressinstitute.org/category/publications/reports/

[4] *See*: http://www.niemanlab.org/2015/11/newsonomics-can-you-get-readers-to-pay-a-dollar-a-day-for-digital-news/

The 2006 Final Regulations provide an exception in certain circumstances when the taxpayer that offers computer software online also sells or licenses software in tangible form or allows customers to download the software. Section 1.199-3(i)(6)(iii). On occasion (although increasingly rare) online newspapers can be downloaded. But online newspaper publishers apparently cannot qualify for this exception, as the 2006 Final Regulations provide that "for example, an electronic book available online or for download is not computer software." Section 1.199-3(j)(3)(i). The favorable treatment accorded to computer software as compared to Internet access information services may be attributable to the fact that computer software was expressly referred to by Congress in Section 199. Section 199(c)(5)(B) of the Code.

The NAA and its members believe that there is no economic reason to make a distinction between advertising income and subscription fees for a tangible newspaper and advertising income and subscription fees for an online newspaper. In both cases, tens of thousands of newspaper employees work to convert words and images into news stories, advertisements and other content. Newspaper publishers spend substantial amounts to insure that such conversions are accomplished each day. Moreover, while newspapers currently are finding it difficult to earn income from print newspapers (thereby often preventing them from benefitting from the section 199 credit), the prospects for earning income from the digital side is more promising. It is hoped that Treasury and the IRS someday will change its views on the treatment of online and digital newspapers under section 199 and extend its benefits to them by regulation or other guidance. Alternatively, if Treasury and the IRS believe it is necessary for such a change to be effected by statute, the NAA and its members hope that Treasury and the IRS will support an amendment to section 199 to permit the manufacturing deduction to be claimed in respect of advertising income and subscription fees for online and digital newspapers.

VII. Conclusion

We hope the above information is useful as you consider finalizing the Proposed Regulations. Please feel free to contact Paul J. Boyle, the NAA's Senior Vice President of Public Policy at (571) 366-1150 if you need additional information or would like to meet with anyone from our industry.

Respectfully submitted,

David Chavern
President and CEO

cc: NAA Taxation Committee
Paul J. Boyle, NAA Senior Vice President of Public Policy
Danielle Coffey, NAA Vice President, Public Policy