IRS Section 199 repeal. What it means for compounding pharmacies

By Scott Sykes

The *Tax Cuts & Jobs Act of 2017* has impacted several areas of the tax code. Although many of the changes are positive for pharmacy owners, one area that may have a negative impact on pharmacies that compound is the repeal of Internal Revenue Service Code Section 199, or the Domestic Production Activities Deduction.

Section 199 provided a tax break to taxpayers who manufactured products for resale and paid employees to assist in the process. Under prior law, pharmacies that compound were considered manufacturers and were eligible for this valuable deduction. Unfortunately, the Section 199 deduction has been repealed for tax years beginning after Dec. 31, 2017. Those pharmacies that compound and were taking the deduction are no longer permitted to do so. Section 199 was replaced with Internal Revenue Service Code Section 199A, or the Qualified Business Income Deduction. This change will impact many pharmacies, not just those that compound.

If you have a pharmacy with revenues from compounding and you were not aware of or were not taking the Section 199 deduction for your compounding income, there is still a small window of opportunity. A taxpayer generally has two years to amend prior year tax returns. Amending prior year tax returns will allow you to claim the deduction and recoup taxes already paid. However, before you amend a prior year tax return to claim the missed deduction, you should be aware of the following key areas:

1. Make sure your books, records, and prior year tax returns are complete and accurate. An amended return may increase your chance of an audit. You should be comfortable with both your pharmacy and personal books, records, and tax returns before embarking on this process.
2. Make sure the deduction is worthwhile. Generally, a pharmacy with compounding revenues with more than 10 percent of total revenues will find it worthwhile to claim the deduction. If compounding revenues are less than 10 percent of total revenues, it may not be sensible to amend. If compounding revenues are more than 10 percent of total revenues, the deduction becomes more meaningful. With that said, due to the previously-mentioned risk concerning amending a return with the IRS, a taxpayer may want to increase the threshold to 15 percent.
3. Always work with a certified public accountant or tax professional who understands Section 199. They must know how it is calculated, which method to use, and how it may impact pharmacies. Understanding the complexity of Section 199 is paramount to maximizing the deduction. If your CPA or tax professional missed the deduction initially, you may not be working with someone competent in this area of tax law.
4. Read the article “Compound Your Way to Lower Taxes” in the December 2016 issue of *America’s Pharmacist* magazine (www.ncpa.co/issues/APDEC16-Compound_Your_Way_to_Lower_Taxes.pdf). This article covers the Section 199 deduction in detail for the pharmacy owner.

Don’t let this opportunity to reclaim prior year taxes slip away, as the savings can be in the thousands of dollars! ■

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