

Excise Tax on Indoor Tanning Services Audit Technique Guide

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NOTE: This guide is current through the publication date. Since changes may have occurred after the publication date that would affect the accuracy of this document, no guarantees are made concerning the technical accuracy after the publication date.

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Chapter 1 Indoor Tanning Services Excise Tax IRC section 5000B

The objectives of this chapter are:

- Provide an overview of Affordable Health Care Act as it relates to the indoor tanning services excise tax.
- Determine what services are subject to the indoor tanning services excise tax.
- Determine who is liable for the tax and when do they become liable for the tax.
- Determine the tax implications of various situations common to the indoor tanning services industry.
- Determine exemptions to the indoor tanning services excise tax.

Overview

Section 10907 of the Affordable Care Act of 2010 (Public Law 111-148), which was signed into law on March 23, 2010, added new section 5000B to the Internal Revenue Code, under Subtitle D, Chapter 49, "Cosmetic Services."

The tax applies to amounts paid for indoor tanning services on and after July 1, 2010.

Law

Code:

Internal Revenue Code section 5000B

Regulations:

26 CFR 49.5000B-1T

Explanation of Provision; overview

Section 5000B imposes an excise tax of 10% on the amount paid for indoor tanning services. The amount paid includes any amount paid for the services by insurance. The indoor tanning services excise tax is a "collected" excise tax (like communications and air transportation excise taxes). The statute provides that the tax is paid by the person on whom the service is performed. Because the tax is generally collected at the time of payment, the regulations provide that the person who pays for the indoor tanning services (payor) is deemed to be the person on whom the indoor tanning services are performed. Thus, for purposes of the indoor tanning services excise tax, the person on whom the services are performed (whether actually performed or deemed performed) is the taxpayer. As discussed below, the person receiving payment for indoor tanning services (provider) is the collector.

Indoor tanning services means a service employing any electronic product designed to incorporate one or more ultraviolet lamps and intended for the irradiation of an individual by ultraviolet radiation, with wavelengths in air between 200 and 400 nanometers, to induce skin tanning. Thus, amounts paid for creams, lotions, sprays, or other non-ultraviolet radiation-based means of inducing tanning are not subject to the indoor tanning services excise tax.

The general rule is that tax is collected by the indoor tanning services provider at time of payment. The regulations provide an exception to this general rule for certain types of gift cards and similar items referred to as undesignated payment cards. An undesignated payment card is defined by the regulations as a gift certificate, gift card, or similar item that can be redeemed for goods or services that may, but do not necessarily, include indoor tanning services. Because it cannot be "reasonably determined" at the time the undesignated payment card is purchased that it will be exchanged for indoor tanning services, the tax is collected at the time the value on the undesignated payment card is actually exchanged for indoor tanning services.

If the person receiving payment for the indoor tanning services does not collect the tax from the payor for the services (or in the case of an undesignated payment card, the person who exchanges card value for indoor tanning services) the provider becomes liable for the tax.

Effective Date

The provision applies to indoor tanning services performed on or after July 1, 2010. Therefore, no tax is due for indoor tanning services sold before July 1, 2010. A sale made before July 1, 2010 is subject to tax if the payment for that sale is not made by the customer until after June 30, 2010. If a payment is made for indoor tanning services before July 1, 2010, but the services are not used until after June 30, 2010, the transaction is not subject to the indoor tanning services excise tax.

Filing requirements

The indoor tanning services excise tax is reported on Form 720, *Quarterly Federal Excise Tax Return*, which is due 30 days after the end of each quarter. The tax is reported on IRS No. 140, Part II of the form.

Deposits

Unlike other collected excise taxes, semimonthly deposits of the tax by collectors are not required for this tax. The total tax for a particular quarter is remitted with the Form 720 quarterly filing.

Cite: § 40.6302(c)-1T(g)

Non-taxable services

Phototherapy Service

The tax is not imposed on phototherapy services performed by a licensed medical professional, such as a dermatologist, psychologist, or registered nurse. The phototherapy services must be performed **on the licensed medical professional's premises**. Thus, if a medical professional prescribes phototherapy services to a patient, and the patient goes to an indoor tanning services salon to receive the prescribed treatment, the amount paid for the indoor tanning services is subject to tax.

Phototherapy service is a service that exposes an individual to specific wavelengths of light for the treatment of:

- dermatological disorders (such as acne, psoriasis, and eczema);
- sleep disorders;
- seasonal affective disorder or other psychiatric disorders;
- neonatal jaundice;
- wound healing; or
- other medical condition determined by a licensed medical professional to be treatable by exposing the individual to specific wavelengths of light.

Cite: § 49.5000B-1T(c)(3)

A medical professional providing phototherapy services may use the same equipment as indoor tanning services providers.

Qualified Physical Fitness Facility

Payments to a Qualified Physical Fitness Facility (QPFF) that includes access to indoor tanning services are not subject to the indoor tanning services excise tax.

A QPFF is a facility:

1. in which the predominant business or activity is providing facilities, equipment and services to its members for purposes of exercise and physical fitness;
2. in which indoor tanning services is not a substantial part of its business; and
3. that does not sell indoor tanning services to the public for a fee or otherwise offer different pricing options to its members based on access to indoor tanning services.

Cite: § 49.5000B-1T(c)(4)

To determine the predominant business or activity of a facility, all facts and circumstances should be considered including, but not limited to, the following:

- the cost of the equipment;
- variety of services offered;
- actual usage of services by customers;
- revenue generated by different services; and
- how the entity holds itself out to the public through advertising or other means.

Cite: § 49.5000B-1T(c)(4)(i)

Note: Any membership fees paid to a facility that offers indoor tanning services but that does not meet the requirements to qualify as a QPFF, is subject to the indoor tanning services excise tax. The portion of the membership fee attributable to indoor tanning services must be calculated and tax imposed at the time payment for the membership fee is made.

Payments for indoor tanning services to organizations that are exempt from income tax, such as universities or private clubs, **are subject** to the indoor tanning services excise tax unless the facility qualifies as a QPFF.

Overview of Indoor Tanning Services Industry

Sales and Pricing

Generally, indoor tanning services are sold through a package of tans or membership fees in which payment is made through Electronic Funds Transfers (EFT). It is unusual for a provider to sell a single indoor tanning session to a customer. Rather, indoor tanning services are commonly sold:

- on a per-minute basis;
- on a per-tan basis;
- through a monthly membership fee for unlimited use of the indoor tanning facilities or reflecting a specific number of tans per month; or
- in a package with other goods or services.

Pricing for indoor tanning services commonly varies with the type of tanning bed used by the customer. The average price of an indoor tanning services session is around six dollars; however, the price can be much higher than this amount.

Terminology

Indoor tanning services providers may use various terms that are common in the indoor tanning services industry, but that may be unfamiliar to those outside of the industry. For example, tanning beds are often referred to as "tanning rooms." This term is used because the tanning bed is enclosed in a room for the customer's privacy. Because indoor tanning services packages are sold based on the type of bed, a provider may state that "this room is not taxable" - meaning that the tanning bed may use spray-on chemicals rather than UV light.

Capital Investment

The capital investment to open an indoor tanning services salon can be considerable. Tanning beds can cost from \$2,000 to \$25,000 at wholesale prices. A tanning bed that costs \$25,000 at wholesale can have an MSRP of \$65,000. Thus, an upscale salon may invest \$500,000 in tanning equipment alone.

Sources of Information

Information on the tanning industry is publicly available on the internet.

Link to the ITA (Indoor Tanning Association) web site:

<http://www.theita.com/>

Site about training requirements and listing of state license points of contact:

<http://www.tanningtraining.com/reginfo/state.html>

Tanning Forums:

<http://www.tantalk.com/>

<http://www.tantoday.com/forums/>

Wikipedia discussion on tanning bulb types, usage, and life span:

http://en.wikipedia.org/wiki/Tanning_lamp

Tax application

This section discusses various payment scenarios in the indoor tanning services industry and how the rules outlined above apply to those scenarios.

Basic Transaction

When a payment is made for indoor tanning services, including the pre-purchase of multiple indoor tanning services sessions, tax is imposed at the time payment is received. For example, if a customer purchases one indoor tanning services session for \$15.00, the tax is 10% of the total amount paid for the indoor tanning services, in this case \$1.50. The provider must collect the tax at the time the indoor tanning services are paid for by the customer. The provider should receive \$16.50 from the customer and pay over \$1.50 to the government.

If a customer pays \$90.00 (not including the indoor tanning services excise tax) for a book of 10 coupons, which are good at any time for indoor tanning services, the tax is 10% of the total amount paid for the indoor tanning services, in this case \$9.00. The provider must collect the tax at the time of payment by the customer for the indoor tanning services, and not when the customer actually uses the coupons. The provider should receive \$99.00 from the customer and pay over \$9.00 to the government.

Cite: § 49.5000B-1T(b)(1), (d)(1), (e)(1), and (f)

Other goods and services

Customers of indoor tanning services facilities will often purchase other goods and services in addition to indoor tanning services. Other goods and services that might be purchased at the same time as indoor tanning services include, but are not limited to, the following:

- protective eyewear;
- footwear;
- towels;
- tanning sprays, creams and or lotions;
- manicures and pedicures;
- other spa treatments; and
- access to sport or exercise facilities.

Cite: § 49.5000B-1T(c)(2)

Other goods and services - indoor tanning services separately stated

If a customer purchases indoor tanning services and other goods and services, the charges for which are all on one invoice, then the charges for the other goods and services are excludable from the tax base if the charges:

- are separable (regardless of the manner of invoicing the charges);
- do not exceed the fair market value of such other goods and services; and
- are shown in the exact amounts in the records pertaining to the indoor tanning services charge.

Cite: § 49.5000B-1T(d)(2)

Fair market value may be determined by considering the amounts charged by competitors in the local area for similar products and services.

Undesignated Payment Cards

An undesignated payment card is a gift certificate, gift card, or similar item that can be redeemed for goods or services that may, but do not necessarily, include indoor tanning services.

Cite: § 49.5000B-1T(c)(5)

As discussed above, liability for the indoor tanning services excise tax arises at the time of payment for the indoor tanning services. If it cannot be determined whether an amount was paid for indoor tanning services, such as when an undesignated payment card is purchased, then the liability does not arise until the provider can reasonably determine that the amount paid is for indoor tanning services. Thus, there is no indoor tanning services excise tax liability when the undesignated payment card is purchased.

Cite: § 49.5000B-1T(b)(2)

It can be reasonably determined that a payment was made for indoor tanning services when an undesignated payment card is redeemed, in whole or in part, for indoor tanning services.

The provider of the services calculates the tax on the amount of the undesignated payment card that is redeemed for indoor tanning services at the time that it is redeemed for those services. The person who redeems the card for indoor tanning services is liable for the tax on the service.

Cite: § 49.5000B-1T(e)(2)

The provider can charge the person who redeems the card for indoor tanning services by accepting cash for the tax or by debiting the card.

If the indoor tanning services excise tax is not collected at the time that the undesignated payment card is redeemed, in whole or in part, for indoor tanning services, then the provider is liable for the tax.

Cite: § 49.5000B-1T(e)(3)

Bundled Services

Bundled services are packages sold by providers that include indoor tanning services and other goods and services and for which each item in the package is not itemized on the customer invoice or otherwise not itemized for the customer.

Cite: § 49.5000B-1T(d)(3)

The preamble to the regulations explains:

If the charges are not separately stated, but the total amount paid covers indoor tanning services, then the tax is based on the portion of the amount paid that is reasonably attributable to the indoor tanning services. For example, if the provider sells bundled services in which the indoor tanning service is bundled with other goods and services, and the charge is not separately stated, the tax applies to the amount paid that is reasonably attributable to the indoor tanning services. This is consistent with the approach taken in Rev. Rul. 63-155 (1963-2 CB 566) (relating to the application of the section 4261 tax on transportation by air to a package tour sold by a hotel that includes airfare, hotel accommodations, and other services not subject to the section 4261 tax).

The regulations provide that if a provider offers indoor tanning services bundled with other goods and services, the payment for the bundled services includes an amount paid for indoor tanning services. The tax applies to that portion of the amount paid to the provider that is reasonably attributable to indoor tanning services (see below for details on performing this calculation). Thus, if a package is sold in which the indoor tanning services is at a "reduced rate" or provided for "free," or includes unlimited indoor tanning services, then a calculation must be made to determine the portion of the package price applicable to indoor tanning services.

Cite: § 49.5000B-1T(d)(3)

Calculating the amount paid to the provider that is reasonably attributable to indoor tanning services

Method for when provider sells both bundled and unbundled services:

The amount reasonably attributable to indoor tanning services may be determined by applying to the total amount paid a ratio determined by comparing-

1. The provider's charge for indoor tanning services not in bundled services;
to
2. The provider's charge for indoor tanning services not in bundled services plus the provider's charge for the other goods and services in the bundled services.

Cite: § 49.5000B-1T(d)(3)

Method for when provider only sells bundled services:

The amount reasonably attributable to indoor tanning services may be determined by applying to the total amount paid a ratio determined by comparing-

1. The fair market value of similar indoor tanning services (based on the amount charged by comparable providers in the same geographic area);
to
2. The fair market value of similar indoor tanning services plus the fair market value of similar goods and services (based on the amount charged by comparable providers in the same geographic area).

Cite: § 49.5000B-1T(d)(3)

The difference between an undesignated payment card and bundled services is that the undesignated payment card can be redeemed entirely for non-taxable services. However, the purchase of bundled services always includes access to indoor tanning services and therefore tax attaches when payment is received. The preamble to the regulations specifically states: "In addition, for purposes of these regulations, payments for indoor tanning services are subject to tax, regardless of actual usage."

Tax is presumed to be included in the indoor tanning services charge

If the invoice for indoor tanning services does not separately state the tax, the amount shown is presumed to include the indoor tanning services excise tax. Cite: § 49.5000B-1T(f). In this situation, the tax is calculated by multiplying the total invoice amount by 0.09091. The result of this calculation is the amount of the indoor tanning services excise tax that is presumed to be included in the total amount of the invoice. For example, if the invoice shows a \$15.00 charge for indoor tanning services, but does not separately state the indoor tanning services excise tax,

then \$1.36 of the \$15.00 is attributable to the indoor tanning services excise tax ($\$15.00 \times 0.09091$) and \$13.64 ($\$15.00 - \1.36) is attributable to the indoor tanning services.

Examples of tax calculation:

Calculating the tax due when customer purchases only indoor tanning services

Liability for the tax arises at the time of payment for the indoor tanning services. Cite: § 49.5000B-1T(b)(1). Payments for indoor tanning services are subject to tax, regardless of actual usage. If a person pays for indoor tanning services to be provided at some future date, the payment is subject to tax at the time the payment is received by the provider.

An example of a person paying for indoor tanning services to be provided at some future date is a person purchasing a pre-paid book of coupons or a pre-paid card good for future indoor tanning services (and redeemable only for indoor tanning services). The tax is calculated on the total amount paid for the coupon book or card at the time payment is made. If the coupon book contains additional "bonus" coupons that can be exchanged for free indoor tanning services, then the calculation will not change because the tax base is the total amount paid for the indoor tanning services.

Example 1: If a customer is charged \$15.00 (before the application of the indoor tanning services excise tax) for one indoor tanning services session and the invoice for the session separately states the tax, then the tax is 10% of the total amount paid, \$15.00. Therefore, \$1.50 is the tax that must be collected at the time of payment.

Example 2: If a customer is charged \$80.00 (before the application of the indoor tanning services excise tax) for five indoor tanning services sessions and gets one session free, and the invoice for the sessions separately states the tax, then the tax is 10% of the total amount paid for the six sessions, \$80.00. Therefore, \$8.00 is the tax that must be collected at the time of payment.

Calculating the tax due when customer purchases indoor tanning services along with other goods and services not sold as part of a bundle

If a customer purchases indoor tanning services along with other goods and services (see discussion above), the charges for which are all on one invoice, then the other goods and services are excludable from the tax base if the charges:

- are separable (regardless of the manner of invoicing the charges);
- do not exceed the fair market value of such other goods and services; and
- are shown in the exact amounts in the records pertaining to the indoor tanning services charge.

Cite: § 49.5000B-1T(d)(2)

Fair market value may be determined by considering the amounts charged by competitors in the local area for similar products and services.

Example: A customer purchases an indoor tanning services session for \$15.00, protective eyewear for \$2.00, and footwear for \$2.00. The total purchase is \$19.00. Each service and item purchased is separable from the other purchased items. In addition, the amount charged by the provider for the protective eyewear and footwear does not exceed the fair market value of those goods. The provider's records show the exact amounts charged for each good and service that it sells. To determine the amount of indoor tanning services excise tax for this transaction, simply calculate 10% of the amount paid for the indoor tanning services (\$15.00), which is \$1.50. The other items are not included in the indoor tanning services excise tax base, and thus not subject to the tax, because they were separately stated, did not exceed fair market value, and were shown in the exact amount on the invoice.

Calculating the tax due when customer purchases indoor tanning services along with other goods and services that exceed fair market value

If a customer purchases indoor tanning services along with other goods and services, the charges for which are all on one invoice, but the charges for the other goods and services exceeds the fair market value of those other goods and services, then the charge for those other goods and services must be adjusted to determine the correct value and tax on the indoor tanning services.

Example: A customer purchases a bundled package of services for \$19.00, but the invoice overstates the value of the other goods and services purchases. The invoice lists one indoor tanning services session for \$6.00, eyewear for \$6.00, and footwear for \$7.00. If the fair market value for eyewear and footwear is \$2.00, then the charge for these items must be adjusted because the values were overstated and the value for indoor tanning services was understated. The indoor tanning services charge should be \$15.00, not \$6.00. In this case, the indoor tanning services excise tax is computed as 10% of \$15.00, which is \$1.50.

Calculating the tax due on redemption of undesignated payment cards for services

An undesignated payment card may be redeemed for a variety of services offered by the provider, including indoor tanning services. Cite: § 49.5000B-1T(c)(5). The provider of the services calculates the tax on the amount of the undesignated payment card redeemed for indoor tanning services at the time value on the undesignated payment card is redeemed for indoor tanning services. Cite: § 49.5000B-1T(b)(2). If the undesignated payment card is not used for indoor tanning services, then there is no indoor tanning services excise tax liability.

Example: On July 1, 2010, a customer purchases a \$150 gift card that can be redeemed for a variety of salon services, including indoor tanning services. The gift card that the customer purchased is an undesignated payment card. As a result, the indoor tanning services excise tax is not imposed when the customer purchases the gift card because it cannot be determined at the time of the sale that the person is going to purchase indoor tanning services. If the cardholder redeems the gift card to pay for indoor tanning services valued at \$22, then the provider should collect the indoor tanning services excise tax, in the amount of \$2.20 ($\$22 \times 10\%$), at the time the indoor tanning services is provided.

Calculating the tax due for a bundle of services that includes "free," reduced rate, or unlimited tanning services

An indoor tanning services provider may offer bundled services to its customers that are advertised to include "free" or discounted indoor tanning services. In such cases, the indoor tanning services excise tax must be calculated on the portion of the payment that is reasonably attributable to the indoor tanning services. When the value of the indoor tanning services is not stated, the amount reasonably attributable to indoor tanning services may be determined by applying to the total amount paid a ratio determined by comparing:

1. The provider's charge for indoor tanning services not in bundled services to
2. The provider's charge for indoor tanning services not in bundled services **plus** the provider's charge for the other goods and services in the bundled service

or

1. The fair market value of similar indoor tanning services (based on the amount charged by comparable providers in the same geographic area) to
2. The fair market value of similar indoor tanning services **plus** the fair market value of the other goods and services in the bundled services (based on the amount charged by comparable providers in the same geographic area).

Cite: § 49.5000B-1T(d)(3)

Example: A salon operator offers a special bundle price for 10 swimming lessons and two "free" indoor tanning services sessions for \$200. Outside of the bundled services, the operator charges \$20 for each swim lesson and \$15 for each indoor tanning services session. Thus, if a customer purchased each item in the bundle separately, the customer would be charged \$230 (10 x \$20 plus 2 x \$15). The amount subject to tax for the bundled service is computed as $\$30/\$230 \times \$200 = \26.08 . The indoor tanning services tax is 10% of \$26.08, or \$2.60.

The following is an example of an indoor tanning services provider's website. It reflects various special offers, and pricing methods typical of the industry.

Get your Designer Skin "6 Shooter" shot card! Ask your tanning consultant for details.

New Clients Only: 2 Weeks Tanning in Level 2 Beds \$19.95 (includes 8oz. lotion and eyewear).

Buy Five Ultrabronz Tans, get One FREE

Matrix Mondays - VIP's \$15, guests \$25

Speed of Light Tuesday - Free level 2 tan with the purchase of a \$6 sample

White Leg Wednesdays - Free level 2 tan with the purchase of our Fiji Smooth and Sleek Lotion

Totally Tini Thursdays - \$5 Sun Capsule Sessions with purchase of Fiesta Sun "Tini" \$5+ lotion sample or bottle

FREE Tan Fridays - Level 2 beds, with purchase of \$10 bottle of lotion*

Ultrabronz Supernova Saturdays - VIP's \$15, guests \$25

*** Tax liability:**

Determine the indoor tanning services component of this offer. "Free" tanning in this example is predicated upon a purchase; therefore the charge includes an amount for indoor tanning services.

Assume a level 2 tan is \$10. **Calculation of taxable amount is: $\$10 / \$20 \times \$10 = \5 .**

Explanation: \$10 charge for non-bundled tan, divided by non-bundled charge for a tan plus lotion of \$20 = a ratio of 50%. The bundled price of \$10 multiplied by 50% equals \$5 as the portion of the charge applicable to indoor tanning services of this offer. \$5 multiplied by 10% tax rate = \$0.50, indoor tanning services excise tax.

Insurance Payments

The "amount paid" for indoor tanning services includes all amounts paid, including insurance payments.

Cite: § 5000B(a); § 49.5000B-1T(d)(1)

The tax liability arises at the time of payment to the provider for the indoor tanning services — even if all or some of the amount is reimbursed by insurance. The tax is collected from the person paying for the services.

Cite: § 49.5000B-1T(e)(1)

Example: A customer with insurance receives \$18.00 worth of indoor tanning services from a provider. The indoor tanning services provider files a claim form with the insurance company on behalf of the customer. The provider accepts payment from the insurance company in lieu of receiving payment for the indoor tanning services when it is provided. If the provider does not collect the excise tax of \$1.80 from the person who received the services, then the provider is liable for the tax.

Cite: § 49.5000B-1T(e)(3)

Refunds, Penalties, and Procedure

Refunds

An overpayment is a payment of tax in excess of that which is properly due. *Jones v. Liberty Glass Co.*, 332 U.S. 524, 531 (1947).

There are no special provisions for refunds of the indoor tanning services excise tax; rather, the usual rules apply for math or other errors in which tax is overstated on the original return.

As discussed above, the person paying for the indoor tanning services is deemed to be the person on whom the service is performed for purposes of collecting the tax. Thus, the person paying for the indoor tanning services is liable for the tax at the time of payment. Therefore, if a prepayment is made for indoor tanning services, but those services are never used, no tax refund is allowable because the taxable event is the payment for indoor tanning services rather than the use of the services.

Cite: § 49.5000B-1T(e)(1)

In the case of an undesignated payment card, the indoor tanning services excise tax is collected when it can be reasonably determined that the amount paid is for indoor tanning service - that is, when the undesignated payment card is redeemed for indoor tanning services. If the undesignated payment card is never used, or used for products or services that are not indoor tanning services, no indoor tanning services excise tax is collected. In such a case a refund of the indoor tanning services excise tax is not allowed.

Penalties

Consult the following Internal Revenue Manual sections for information about penalties applicable to the indoor tanning services excise tax:

- IRM 4.24.9.3 - Delinquency Penalty (§ 6651)
- IRM 4.24.9.4 - Trust Fund Recovery Penalty (§ 6672)
- IRM 4.24.9.6 - Return Preparer Penalty (§ 6694)
- IRM 4.24.9.10 - Penalty for Refusal to Permit Entry of Examination (§ 7342)

The indoor tanning services excise tax is subject to the above-listed excise penalties, which includes delinquency penalties under IRC section 6651(a)(1) for failure to file, and IRC section 6651(a)(2) for failure to pay.

The indoor tanning services excise tax is a "collected" tax. Collected taxes are held in special trust for the United States, and any person who willfully fails to collect and pay over the tax may be subject to additional penalty under IRC section 6672 (Trust Fund Recovery Penalty).

(Note that the Trust Fund Recovery Penalty requires a separate extension of the statute of limitations in addition to any extension required of the Collector).

Statutes of Limitation

Form 872-B, Consent to Extend the Time to Assess Miscellaneous Excise Taxes, should be secured to protect the liability of collected taxes under section 7501.

For the indoor tanning services excise tax, the Form 872-B should specify the following:

"The amount of liability for collecting and remitting IRC 5000B, Indoor Tanning Services Excise Tax, imposed on the taxpayer(s) by section 7501 of the Internal Revenue Code."

As discussed above, if the indoor tanning services provider does not collect the tax at the time of payment for the indoor tanning services, the provider is liable for the tax under § 49.5000B-1T(e)(3). In that case, Form 872-B, Consent to Extend the Time to Assess Miscellaneous Excise Taxes, should be secured to protect the liability for the excise tax under section 5000B and § 49.5000B-1T(e)(3). The Form 872-B should specify the following:

"The amount of liability for remitting IRC 5000B, Indoor Tanning Services Excise Tax, imposed on the taxpayer(s) by section 5000B of the Internal Revenue Code and § 49.5000B-1T(e)(3) of the Treasury Regulations."

Form 2750, Waiver Extending Statutory Period for Assessment of Trust Fund Recovery Penalty, is to be secured for each tax period under examination. The form can be prepared for the entity or for each responsible official depending upon the facts and circumstances of the case.

The period for assessment against the collector under sections 6672 or 7501(a) also is determined by reference to the filing date of the collector's return on which the tax should have been reported. (Office of Chief Counsel Internal Revenue Service Memorandum dated 1/9/03, Index No. 1362.01-03.)

Note: The IRS will generally administer the indoor tanning services excise tax the same way it administers the other collected excise taxes in Chapter 33 of the Code (communication and transportation taxes). However, IRC section 4291 does not apply to the indoor tanning services excise tax since IRC section 4291 applies to Chapter 33 taxes only. Rather, a similar provision is provided under IRC section 5000B(c).

There is no requirement to solicit a statute waiver from the person paying for the indoor tanning services excise tax.

Collected Tax - Secondary Liability

The indoor tanning services excise tax is a collected tax and the person receiving payment for the services must collect the tax. If the person paying for the indoor tanning services does not pay the tax to the person receiving the payment for the services at the time of payment for the services, the person receiving the payment is liable for the tax. Cite: § 5000B(c)(3); § 49.5000B-1T(e)(3). In such a case, the tax may be directly assessed against the service provider. See the previous section regarding extending the statute of limitations in this situation.

Collected Tax - IRC Section 6672 Trust Fund Penalty

Because the indoor tanning services excise tax is a collected tax, the assessable penalty of section 6672 is available when a tax assessment cannot be collected from the provider. This penalty may apply in a variety of scenarios, including when the provider ceases to do business; when the provider is bankrupt; or when an assessment cannot be collected for some other reason. In these cases, the responsible persons should be assessed the IRC section 6672 penalty as outlined in IRM 4.24.6.14.1.

Chapter 2 Examination Techniques

The objectives of this chapter are:

- Present audit issues
- Present audit techniques
- Present indirect methods of tanning revenue determination including bank deposit method

Overview

There are thousands of tanning salons in the United States. Also, thousands more tanning beds are located in other types of businesses, such as health clubs, spas, beauty salons, laundromats, apartment complexes, retail gas stations. In these cases, the indoor tanning services may not be advertised and therefore may not be readily apparent to the casual observer.

In many cases, tanning salons are stand-alone, single-entity businesses. However, some companies operate several salons in a local geographical area. There are also a number of large chain providers that operate as franchises; and each franchise is independently owned and operated. There are relatively few large players in this industry. A larger-sized tanning salon might see \$500,000 in total revenue during a single year. The revenue distribution for this type of operation is usually weighted heavily on the side of revenue from indoor tanning services - perhaps \$350,000 of the total amount. The remaining revenue for this type of operation usually comes from tanning-related products, such as spray tans, lotions, and other items.

Examination Issues

Sales of indoor tanning services, whether sold individually, as a package of two or more sessions, or as unlimited-usage monthly memberships, does not require any special accounting. As discussed in Chapter 1, the amount paid for the indoor tanning services forms the tax base for this tax, and that amount is the amount subject to the tax. The examiner, however, must be alert for the situations in which the sale of indoor tanning services is not subject to the tax at the time the service is provided (for example, when a customer purchases an undesignated payment card), or when the selling price must be adjusted to determine the tax base (for example, when a customer purchases bundled services).

Undesignated Payment Cards

One situation that requires special attention is the payment for undesignated payment cards. As discussed in Chapter 1, an undesignated payment card is a gift card that can be redeemed for a variety of goods and services at a salon, including, but not limited to, indoor tanning services. When an undesignated payment card is sold, it cannot reasonably be determined that the amount paid is for indoor tanning services until value on the card is actually redeemed for indoor tanning

services. Thus, the purchase of an undesignated payment card is not taxed. Instead, tax liability arises when the value on the card is redeemed, in whole or part, for indoor tanning services.

The examiner must inquire about and review the records kept to reflect these liabilities incurred and collected after payment for the undesignated payment card. The examiner should ask how indoor tanning services are tracked, and tax booked, when undesignated payment cards are redeemed for indoor tanning services.

If the provider's records reflect little or no accruing liability for such future delivered tanning service or the accuracy of the liability in general, the examiner may need to use an indirect method to ascertain the indoor tanning services usage.

The examiner may want to request the provider to walk through all of the various pricing strategies that the provider offers. The examiner also may want to ask about how indoor tanning services revenue data is captured and how excise tax is calculated on that amount.

"Free" tanning

Verify that the provider is accounting for "free" and reduced rate indoor tanning services, which are commonly offered with a customer's purchase of another item. Compute the tax after determining the value of the indoor tanning services (see Chapter 1 for details). Examine internet and promotional materials for this method of marketing. Verify that the provider is accounting for these promotions by determining that the provider has procedures in place to capture indoor tanning services revenue in these situations. See "Calculating the tax due for a bundle of services that includes "free," reduced rate, or unlimited tanning services" in the section "Examples of tax calculation" in Chapter 1.

If the provider provides truly free indoor tanning services to a customer, where no payments are made for the indoor tanning services or for any other products or services offered by the provider, then there is no tax liability. This is because indoor tanning services excise tax liability arises only when an amount is paid for indoor tanning services.

Other fees

A common situation in the tanning industry is to pay a registration or similar fee, then pay monthly fees for the right to access tanning services at the frequency provided in the plan. In addition, there may be fees paid monthly that preserve the patron's right to continue the plan while skipping one or more months.

The payment of these so called "freezes" enable the patron to continue without having to pay a new registration fee upon start up of access to the monthly plan's terms. These fees are not subject to tax because they are not payments for indoor tanning services. Cite: Rev. Rul. 70-515, 1970-2 C.B. 270.

Red Light Beds

Some tanning salons offer "red light" bed tanning sessions. A red light bed employs lamps that do not emit ultraviolet radiation. Because the lamps in these beds do not emit ultraviolet radiation, a service that uses a red light bed does not meet the definition of indoor tanning services. Therefore, payments for these services are not subject to the indoor tanning services excise tax.

Excise Examination

Provider Interview:

Issues to address:

- Visitation to the business, observe customer volume and methods of payment.
- Understand overall operations of the business.
- Determine duties of personnel, especially relating to recording sales and how any manual or automated bookkeeping process is engaged.
- Determine nature and type of records kept.
- Request that the provider estimate the revenue received by cash vs. credit or debit card and to which bank and account the sales revenues are deposited.
- Request that the provider explain the methodology used to identify and account for taxable services.
- Request that the provider provide data and records regarding the various tanning session prices, average price of a tan, etc.
- Request that the provider provide data regarding the average length of time per tanning session.
- Request that the provider detail how maintenance service is logged on tanning beds, how usage is recorded and how often it's recorded.
- Compare the statements provided by the provider to what you observe at the business, what is listed on internet sites, or otherwise stated in written or other types of promotions, and determine if there are any inconsistencies.

Internal Controls

The examiner should analyze and evaluate the internal controls regardless of the bookkeeping method used by the provider. This analysis helps to establish the veracity of the provider's accounting and record keeping system.

IRM 4.10.4.3.3.4 Evaluation of Internal Controls (Individual Business Return)

- Document the business operation, accounting system, assets, flow of transactions, procedures for safeguarding business operations.
- Determine the reliability of the books and records, understand the business operation, and verify safeguards.
- Determine weak internal accounting systems.

Reconcile return to books/records

IRM 4.10.4.3.3.5

Request trial balance (if any), summary sheets, work papers and determine the audit trail either for manual or automated record keeping systems, for all transactions.

During this process, request that the provider walk you through typical transactions and show you how the information is captured by their accounting system.

- Request that all appropriate documents (trial balance, journals, summaries, work papers, etc.) be available for this review.
 - **Note:** Your initial phone call for an appointment with the provider should determine the type of records that are available.
- While reviewing the books and records, determine the revenue categories. Note that in most jurisdictions the rules for sales tax reporting will reflect various categories such as tanning, sprays, lotions, and other products.
- Request that the provider detail the audit trail from initial sale to recordation in its books to the preparation of Form 720, using the actual documents for each type of sale and special offer.
- If the provider maintains accounts in a General Ledger, determine the account used for excise tax, such as excise tax payable. Reconcile the account to the provider's books and records, and note unusual or large debits.
- Review the amount of indoor tanning services excise tax paid over to the IRS in prior periods, if any, and request an explanation for large variances. Note that the local climate impacts sales.
- Reconcile gross receipts per the provider's income tax return to filed Forms 720. Remember that the income tax return will reflect total revenue, but the Form 720 will reflect revenue adjusted to show revenue from only indoor tanning services.

Tanning-industry specific software

There are specialized software providers covering the industry. In most cases, the software companies have updated their products to account for the indoor tanning services excise tax. The principal companies in the industry are:

- Helios
- Sun Touch
- Sun Lync

The use of specific software is generally related to internal controls and compliance with state or federal regulations controlling the time a person can be subjected to ultraviolet radiation and/or to control the timing and usage of the tanning facility. In many, if not most, cases, the owner or operator is not on site and the software controls access to the tanning equipment by ensuring that the tanning bed use is started via a proper sequence.

A card, pin number, or other account number, which contains the payment status of the customer, assures that the tanning bed is turned on only for legitimate and proper use.

The provider should be able to print various reports of activity of the entire business, as well as a particular tanning device or bed. For example, a print of a bed's activity for a yearly or other period may show that it is subject to tax for a period and then show that the bed was not taxable for the remainder of the year. The provider should be able to provide a reason for the change in the bed's taxable status. It may be that the particular bed was replaced with a non-taxable spray bed.

Reconstructing or verifying indoor tanning service revenue

The provider's bookkeeping system may give indoor tanning services (services subject to the excise tax) a specific code or category. The amounts recorded under the code or category is totaled, potentially adjusted for some reason, and used to prepare summary reports that should tie to the amount shown on Form 720 for indoor tanning services excise tax. When reports produced by the bookkeeping system ties to the Form 720, the examiner must test the numbers comprising the totals on the reports. Basic source checks such as total, deleted items, incorrect accounting procedures, incorrect or unallowable adjustments to indoor tanning services sales may be buried in the totals. A cursory review of the provider's bookkeeping procedures may appear to be adequate.

If the examiner determines that a thorough test or reconstruction of the books and records is necessary, the examiner may use one or more of the methods listed below. Before undertaking the test or reconstruction, keep the big picture in mind. Will the total amount of time you will spend on any indirect method provide any more benefit than less time-intensive procedures? Consider the business's location, size, appearance, foot traffic, and any other issues noted in the interview section - as well as your personal knowledge - which points to an inconsistency in gross indoor tanning services revenue (which will then reflect the amount the indoor tanning services excise tax collected by the provider).

1. Indirect Methods

Indirect methods include:

- Monitoring of hours via a meter or counter on a tanning bed. To employ this method:
 1. Count the hours that each bed was used for a month or quarter.
 2. Divide the total number of tanning hours by the amount determined by multiplying the average time per tan by the average charge per tan.
 3. If this calculation is performed for a month rather than a quarter, extrapolate for a quarter by multiplying the month amount by 3.
 4. Compare the estimated quarterly revenue amount to the reported tanning revenue by dividing the reported tax by 0.10. Remember that the accuracy of this method depends upon the accuracy of the average time per tan and average charge per tan.
- Determining frequency of tanning bed bulb purchases or other usage methods. (Differences in pricing structures may make the hours of bed usage impractical.)
Considering bulb usage can also be problematic in that low-pressure bulbs have a useful life of 300 to 700 hours, and some operators can stretch usage for 1,000 hours for the same bulb. However, the effectiveness diminishes. High pressure bulbs last considerably less time due to potential ballast damage also if not changed at the end of its life span.
See the link to a Wikipedia article on tanning bulbs under "Sources of Information" in Chapter 1.
- Electricity usage. Look for usage inappropriately high for the number of tanning beds stated. Note: Check the internet for a location as close to you as possible since there are numerous posts on electricity usage.
- Cost of Goods Sold to determine costs of non-tanning items. Compute a markup to determine revenue derived from non-tanning products.
- Inventory records and purchase records of supplies used in the tanning process such as eyewear, footwear, specific lotions.
- Inventory records and purchases of products and determination of other services rendered to estimate the non-tanning revenue percentage of total revenue.
- Manual or electronic appointment calendars, books, sheets or other devices that will reflect tanning (appointments alone, however, will likely give you no information as to the type of tanning plan the customer is enrolled in).

Although it is difficult to back into indoor tanning services revenue by usage because of the various promotions that a customer may use, the items listed above are areas to consider if you are in a position of having to reconstruct records.

Using an indirect method may be more beneficial than using a direct method if it is necessary to reconstruct the books and records. Using an indirect method also may be beneficial when verifying the accuracy of the tanning revenue amounts. Indirect methods include revenue based methods such as bank deposits.

2. Bank Deposits /Electronic Funds Transactions (EFT)

Tanning salons are moving toward receiving their fees by charging debit and credit cards. This business model is similar to those used by health clubs, which seek to sign an individual to an EFT plan, i.e. automatic debits from the customer's account to pay for monthly membership fees. This is the preferred method of sale, although sales by the tan, by the minute, and other varying methods of billing may be offered. The debit/credit portion of revenue accounts for 80 to 90 percent of total revenue, with the remainder received as cash. The provider's bank accounts will reflect the EFT for these amounts. Analyzing the bank accounts for the EFT credits and comparing to the book amounts listed for tanning will provide a quick indirect method for verifying indoor tanning services revenue.

However, due to the size of the business, or for some other reason, a particular provider may receive more payments in cash. Use your business site visit to observe payment procedures and types.

- Accounts at banking institutions issuing a credit or debit card, and belonging to the Automated Clearing House (ACH) network, are capable of receiving queries via EFT to debit the accounts for customer purchases. Merchants subscribe to a clearing service, which provides real time clearance of credit or debit cards. Usually a terminal (commonly a card-swipe device) is provided to the merchant to access the network, debit the card used, and issue acknowledgments to the cardholder and merchant. The transactions are totaled and credited to the merchant's account at prescribed intervals, usually taking three days to complete.
- Bank Deposit Analysis (Individual Business Returns) see IRM 4.10.4.3.3.6. Explanation and process of the bank deposit method.
- **The examiner should use judgment in determining the depth of the analysis.** It may be necessary to reconcile the EFT deposit transactions to reported gross income in the books and records. The bank deposit data may be your primary method if no books and records were kept, or it may be a check of the data provided in the books and records. However, it will not account for any cash sales that are not deposited. It may be necessary to estimate cash sales to add to the bank deposits analysis. However, the examiner should keep in mind the cost, in terms of time necessary to do a complete bank deposit analysis, versus the expected benefits of performing such an analysis.
- The examiner should also consider employing one or more of the indirect methods listed above. Analyze a specific period for appointments kept manually or electronically. A less reliable approach is bulb usage, but each of the stated methods should be considered. Note that there will be variables by geography, time of year, and the demographics of the area where the salon is located.
- Most credit or debit transactions occur at the point of sale. There are numerous companies providing the vendor with EFT capable transaction processing. However, some providers accept internet-based payments. The following is from an internet ad of a company specializing in providing internet payment services to any type of vendor with an internet site. It explains the general EFT process.
Internet based purchases via EFT:
 1. Customer visits your web site and chooses to buy your product/service.
 2. Customer completes an order form on your web site, securely providing credit card or check info.

3. Completed form is submitted to our secure server for verification.
 4. You receive real-time online authorization from our server.
 5. Order confirmation is immediately sent to you and to customer.
 6. Customer's credit card or checking account is debited; your bank account is credited.
 7. The transaction appears on customer's credit card or checking account. statement
- If the provider you are examining receives payments primarily in cash, then the bank deposit method will be of limited use. In that case, you should use any indirect method to back into gross receipts as outlined previously.

Additional pre-audit examination steps:

- Check provider internet sites.
- Review promotional literature and other advertising media for information on how the salon is marketed to customers.
- Attempt to reconcile provider's income tax return to its filed Form 720, especially if the provider's primary business is tanning. Until a full year of filed Form 720s are available, review provider's prior income tax returns and records of revenue by quarter, and compare to the provider's last-filed Form 720.

Badges of Fraud

- As with any case, consider the possibility of fraud during your examination if appropriate.
- The following are some common fraud indicators:
 - Omission of entire sources of income.
 - Omission of specific items of income while others are included.
 - Concealment of income.
 - False documents and statements.
 - Failure to file especially over a prolonged period.

Consult with the fraud liaison in your area for assistance with determining whether your case meets the fraud criteria.

IDR Language:

1. Provide the address of each indoor tanning services location, including the number of tanning beds, upright tanning stations, and other facilities used to provide indoor tanning services at each location.
If any indoor tanning services location has a separate Employer Identification Number please list it separately.
2. Provide the manufacturer and model of each tanning station(s) at each location.
3. Provide the number of employees at each indoor tanning service location. Form 941, Employer's Quarterly Federal Tax Return, for the period(s) ending _____ should be available for inspection.

4. Describe all service delivery options offered, including bundled services, unlimited tanning services, and any other methods.
5. Provide the summary work papers tying the books and records to Form 720, Quarterly Federal Excise Tax Return, IRS line No. 140 for the period(s) ending _____.
6. Sales invoices/receipts for the period(s) ending _____ should be available for review.
7. Provide printouts of General Ledger account for excise tax payable for period(s) ending _____.
8. Electric utility bills for period(s) ending _____ should be available for review for each location.
9. List all situations in which you did not collect excise tax on indoor tanning services, and explain why you did not collect the tax.
10. Records of tanning station usage for the examination period(s) should be available for review.
11. A copy of each of your last two filed income tax return forms should be available for the examiner's retention (for example, Forms 1040 or Forms 1120).
12. Provide a sample of all documents used in recording the indoor tanning services excise tax from the customers receipt through journals, ledger, commercial or other record keeping system.
13. Explain how payments for undesignated payment cards (for example, gift cards or certificates) are recorded.
14. Provide copies of all business and personal bank account statements for the period(s) ending _____.

For Qualified Physical Fitness Facilities:

1. Request documentation that club or other organization with tanning facilities correctly applied the "qualified physical fitness facility" exception.
2. Provide the following records concerning the "qualified physical fitness facility":
 - o Costs of providing indoor tanning vs. all costs of providing fitness facilities.
 - o Revenue derived from indoor tanning service vs. revenue from all fitness facilities.
 - o Records of usage of tanning equipment vs. fitness equipment.
 - o Provide internet sites, brochures, or other promotional material for your physical fitness facility during the period(s) ending _____
 - o Any other records supporting that providing indoor tanning services are not a substantial part of your business or activity.

Link to Frequently Asked Questions

[Excise Tax on Indoor Tanning Services Frequently Asked Questions](#)

Link to Regulation 49.5000B-1T

[Regulation 49.5000B-1T](#)