



# Excise Tax on Indoor Tanning Services Audit Technique Guide

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The taxpayer names and addresses shown in this publication are hypothetical.

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# Table of Contents

- I. Indoor Tanning Tax IRC Section 5000B ..... 5**
  - A. Objectives ..... 5**
  - B. Overview ..... 5**
    - B.1. Law ..... 5**
    - B.2. Explanation of Provision; Overview ..... 5**
    - B.3. Effective Date ..... 6**
    - B.4. Filing Requirements..... 6**
    - B.5. Deposits..... 6**
  - C. Non-Taxable Services ..... 6**
    - C.1. Phototherapy Service ..... 6**
    - C.2. Qualified Physical Fitness Facility ..... 7**
  - D. Overview of Indoor Tanning Services Industry ..... 8**
    - D.1. Sales and Pricing ..... 8**
    - D.2. Terminology..... 8**
    - D.3. Capital Investment ..... 8**
    - D.4. Sources of Information ..... 8**
  - E. Tax Application ..... 9**
    - E.1. Basic Transaction ..... 9**
    - E.2. Tax is Presumed to be Included in the Indoor Tanning Services Charge ..... 9**
    - E.3. Other Goods and Services ..... 10**
    - E.4. Undesignated Payment Cards..... 12**
    - E.5. Examples of Tax Calculation..... 13**

E.6. Insurance Payments .....	16
<b><u>E.</u> Refunds, Penalties, and Procedure .....</b>	<b>17</b>
F.1. Refunds .....	17
F.2. Penalties.....	17
F.3. Statutes of Limitation.....	18
F.4. Collected Tax – Secondary Liability .....	18
F.5. Collected Tax – IRC Section 6672 Trust Fund Penalty .....	19
<b><u>II.</u> Examination Techniques .....</b>	<b>19</b>
<b><u>A.</u> Objectives .....</b>	<b>19</b>
<b><u>B.</u> Overview .....</b>	<b>19</b>
<b><u>C.</u> Examination Issues.....</b>	<b>19</b>
C.1. Undesignated Payment Cards .....	20
C.2. "Free" Tanning.....	20
C.3. Other Fees .....	21
C.4. Red Light Beds.....	21
C.5. Tanning Providers May Receive Revenue from Group Buying Programs.....	22
C.6. Franchise Operations .....	22
C.7. Multiple Business Locations.....	22
C.8. Tanning Banks .....	22
<b><u>D.</u> Excise Examination .....</b>	<b>23</b>
D.1. Provider Interview .....	23
D.2. Internal Controls .....	23
D.3. Reconcile Return to Books/Records .....	24

<b>D.4. Tanning-Industry Specific Software .....</b>	<b>24</b>
<b>D.5. Reconstructing or Verifying Indoor Tanning Service Revenue .....</b>	<b>25</b>
<b>D.6. Additional Pre-Audit Examination Steps .....</b>	<b>28</b>
<b>D.7. Badges of Fraud.....</b>	<b>28</b>
<b>D.8. IDR Language .....</b>	<b>29</b>
<b>D.9. Frequently Asked Questions.....</b>	<b>30</b>
<b>D.10. Link to Regulation 49.5000B-1T .....</b>	<b>30</b>

## **I. Indoor Tanning Tax IRC Section 5000B**

### **A. Objectives**

The objectives of this chapter are to:

- Provide an overview of the indoor tanning tax enacted by the Affordable Care Act.
- Determine which services are subject to the indoor tanning tax.
- Determine the taxable event and the person liable for the tax.
- Determine the tax implications of various situations common to the indoor tanning services industry.
- Determine exemptions from the indoor tanning tax.

### **B. Overview**

The indoor tanning services tax ("indoor tanning tax") is imposed by Internal Revenue Code (IRC) § 5000B and is codified under Subtitle D, Chapter 49, "Cosmetic Services." IRC § 5000B was added by section 10907(b) of the Patient Protection and Affordable Care Act of 2010 (H.R.3590) (Pub. L. 111-148), commonly referred to as the "Affordable Care Act," signed into law on March 23, 2010.

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

#### **B.1. Law**

Code: IRC § 5000B

Regulations: 26 CFR 49.5000B-1

#### **B.2. Explanation of Provision; Overview**

Section 5000B of the Code imposes an excise tax of 10 percent on the amount paid for indoor tanning services. The amount paid includes any amount paid by insurance. The indoor tanning tax is a "collected" excise tax (like communications and air transportation excise taxes). Section 5000B provides that the tax is paid by the person on whom the service is performed. Tax is imposed when the payment is made for the services. Under the regulations, the person who pays for the indoor tanning services (payor) is deemed to be the person on whom the indoor tanning services are performed. As discussed below, the person receiving payment for indoor tanning services (provider) is the collector.

The term "indoor tanning services" generally means services 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, purchases of creams, lotions, sprays, or other non-ultraviolet radiation-based means of inducing tanning are not subject to the indoor tanning tax. The term "indoor tanning services" does not include any phototherapy service performed by, and on the premises of, a licensed medical professional (such as a dermatologist, psychologist, or registered nurse).

- Cites: IRC § 5000B(b) and §§ 49.5000B-1(c)(1) and (c)(2)

The general rule is that tax is collected by the indoor tanning services provider at the time of payment for those services.

Special rules apply to gift cards and similar items (referred to as "undesignated payment cards" in the regulations). These rules are discussed in detail in section E of this guide.

If the person receiving payment for indoor tanning services does not collect the tax from the payor for taxable services, the provider is liable for the tax. Even when the person receiving payment for indoor tanning services does not collect the tax from a payor who is using an undesignated payment card, the person who redeems card value for indoor tanning services is liable for the tax.

### **B.3. Effective Date**

The tax applies to indoor tanning services performed on or after July 1, 2010.

### **B.4. Filing Requirements**

The indoor tanning tax is reported on Form 720, *Quarterly Federal Excise Tax Return*, which is due by the last day of the first month following the quarter for which it is made. The tax is reported on IRS No. 140, Part II of Form 720.

### **B.5. Deposits**

Unlike some 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 quarterly with Form 720.

- Cite: § 40.6302(c)-1(e)(1)(v)

## **C. Non-Taxable Services**

### **C.1. Phototherapy Service**

The tax is not imposed on phototherapy services performed by a licensed medical professional, such as a dermatologist, psychologist, or registered nurse, 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 where there is no licensed medical professional 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: IRC § 5000B(b)(2) and § 49.5000B-1(c)(3)

A medical professional providing phototherapy services on the licensed medical professional's premises might use the same equipment as indoor tanning services providers. This does not disqualify the service from being exempt from tax.

## **C.2. Qualified Physical Fitness Facility**

No payment to a Qualified Physical Fitness Facility (QPFF) that includes access to indoor tanning services is subject to the indoor tanning tax.

A QPFF is a facility:

- In which the predominant business or activity is providing facilities, equipment, and services to its members for purposes of exercise and physical fitness;
- In which indoor tanning services are not a substantial part of its business or activity; and
- 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-1(c)(5)

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.

- How the entity holds itself out to the public through advertising or other means.

## **D. Overview of Indoor Tanning Services Industry**

### **D.1. Sales and Pricing**

Indoor tanning services are sometimes sold through a package that provides a specific number of tanning sessions or membership fees. Indoor tanning services are commonly sold in the following manner:

- On a per-minute 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.

### **D.2. 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 service provided, a provider may state that "this room is not taxable" – which can mean that the service provided is exempt from taxation. For example, the service provided in the room may use spray-on chemicals rather than UV light.

### **D.3. 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.

### **D.4. Sources of Information**

Information on the indoor tanning services industry is publicly available on the Internet.

- Site about training requirements and listing of state license points of contact: National Tanning Training Institute's A Guide to State Radiation Control Offices



- Tanning Forums: tanTalk.com; Tan Today

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

## E. Tax Application

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

### E.1. 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, and the provider separately states the tax on the invoice, the tax is 10 percent 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 remit \$1.50 to the government. If the provider does not separately state the tax on the invoice, the total amount paid is presumed to include the tax. In that case the tax of 10 percent is presumed included in the total charge of \$15. The amount of the tax remitted would be \$1.36. ( $\$15 / 1.10 \times .10$ )

- Cite: § 49.5000B-1(d)(1)(i) and (g) *Example 1(i)*.

If a customer purchases a book of 10 indoor tanning service coupons, which are good at any time for indoor tanning services, for \$90 (not including tax), the tax is 10 percent of the total amount paid for the indoor tanning services, in this case \$9. The provider must collect the tax at the time of payment by the customer for the indoor tanning services, and not when the customer redeems the coupons. The provider should receive \$99 from the customer and pay over \$9 to the government.

- Cite: § 49.5000B-1(b)(1), (d)(1)(i), and (e)(1).

### E.2. Tax is Presumed to be Included in the Indoor Tanning Services Charge

The total amount paid for indoor tanning services is presumed to include the indoor tanning tax if the tax is not separately stated.

- Cite: § 49.5000B-1(d)(1)(i).

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 tax that is presumed to be included in the total amount of the invoice. For example, if the invoice shows a \$15 charge for indoor tanning services but does not separately state the indoor tanning tax, then \$1.36 of the \$15 is attributable to the indoor

tanning tax ( $\$15 \times (10\%/110\%)$  or  $\$15 \times 0.09091$ ) and  $\$13.64$  ( $\$15 - \$1.36$ ) is attributable to the amount paid for the indoor tanning services.

- Cite: § 49.5000B-1(g) *Example 1(ii)*.

### **E.3. 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-1(c)(2)

#### **Indoor Tanning Services Separately Stated**

- If a customer makes a payment to cover charges for indoor tanning services as well as for other goods and services, 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-1(d)(2)

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

#### **Bundled Services (Indoor Tanning Services NOT Separately Stated)**

- Generally, bundled services are packages sold by providers that include indoor tanning services as well as 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-1(d)(3)

If a provider offers indoor tanning services (whether of a specified or unlimited amount, including "free" or reduced-rate 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. The calculation methods for determining the amount paid for indoor tanning services are described below.

The method used to calculate the amount paid to the provider that is reasonably attributable to indoor tanning services depends on how the provider offers its services.

The method used if the provider sells indoor tanning services both as a standalone service or bundled with other goods and services:

- The amount reasonably attributable to indoor tanning services may be determined by applying to the total amount paid a ratio determined by comparing -
  - The provider's charge for indoor tanning services not in bundled services; to
  - 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-1(d)(3)

The method used if the provider only sells indoor tanning services bundled with other goods and services, but sells other goods and services as either part of the bundle or separately stated:

- The amount reasonably attributable to indoor tanning services may be determined by applying to the total amount paid a ratio determined by comparing -
  - The fair market value of similar indoor tanning services (based on the amount charged by comparable providers in the same geographic area); to
  - The fair market value of similar indoor tanning services plus the provider's charge for the other goods and services in the bundled services.

- Cite: § 49.5000B-1(d)(3)

The method used if the provider sells indoor tanning both as a standalone service or bundled with other goods and services but does not sell other goods and services unless bundled with indoor tanning services:

- The amount reasonably attributable to indoor tanning services may be determined by applying to the total amount paid a ratio determined by comparing –
  - The provider's charge for indoor tanning services not in bundled services; to
  - The provider's charge for 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).

The method used if the provider sells indoor tanning services and goods and services as part of a bundle:

- The amount reasonably attributable to indoor tanning services may be determined by applying to the total amount paid a ratio determined by comparing -
  - The fair market value of similar indoor tanning services (based on the amount charged by comparable providers in the same geographic area); to
  - The fair market value of similar indoor tanning series plus the fair market value of similar goods and services (based on the amount charged by comparable providers in the same geographic area).

#### **E.4. 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-1(c)(6)

As discussed above, liability for the indoor tanning 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 an undesignated payment card is redeemed, in whole or in part, to pay for indoor tanning services. Thus, there is no indoor tanning tax liability when the undesignated payment card is purchased.

Cite: § 49.5000B-1(b)(2)

The person who redeems the card, in whole or in part, to pay specifically for indoor tanning services is liable for the tax on the services at the time the payment is made. 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 the amount is paid.

Cite: § 49.5000B-1(e)(2)

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

If the indoor tanning 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-1(e)(3)

#### Undesignated Payment Cards vs. Bundled Services

- 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.

## E.5. 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-1(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 that can be redeemed 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. Cite § 49.5000B-1(d)(1)(iii)

- Example 1: If a customer is charged \$80 for five indoor tanning services sessions plus one "free" session, and the invoice for the sessions separately states an additional amount for the tax, then the tax is 10 percent of the total amount paid for the six sessions, \$80. Therefore, \$8 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-1(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, protective eyewear for \$2, and footwear for \$2. The total purchase is \$19. 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 tax for this transaction, simply calculate 10 percent of the amount paid for the indoor tanning services (\$15), which is \$1.50. The other items are not included in the indoor tanning 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, but the invoice overstates the value of the other goods and services purchases. The invoice lists one indoor tanning services session for \$6, eyewear for \$6, and footwear for \$7. If the fair market value for eyewear and footwear is \$2 each (\$4 total), 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, not \$6. In this case, the indoor tanning tax is computed as 10 percent of \$15, 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-1(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 that value on the undesignated payment card is redeemed for indoor tanning services. Cite: § 49.5000B(b)(2).

If the undesignated payment card is not used for indoor tanning services, then there is no indoor tanning 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 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 redeem the gift card for 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 tax, in the amount of \$2.20 ( $\$22 \times 10$  percent), at the time that the cardholder pays for the indoor tanning services.

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 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 separately stated, the amount reasonably attributable to indoor tanning services may be determined by applying to the total amount paid a ratio determined by comparing:

- The provider's charge for indoor tanning services not in bundled services; to
- 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, if the provider only charges for indoor tanning services and for the other goods and services as part of bundled services,

- The fair market value of similar indoor tanning services (based on the amount charged by comparable providers in the same geographic area); to

- 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-1(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 percent of \$26.08, or \$2.60.

Do a Google search for "tanning" services and you will find many examples of indoor tanning services provider's websites. They will reflect various special offers, and pricing methods used in the industry.

Tax Liability on "Free" Tanning with Separate Purchase (FREE Tan Fridays - Level 2 beds, with purchase of \$10 bottle of lotion):

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 percent. The bundled price of \$10 multiplied by 50 percent equals \$5 as the portion of the charge applicable to indoor tanning services of this offer. \$5 multiplied by 10 percent tax rate = \$0.50, indoor tanning tax.

## E.6. Insurance Payments

The "amount paid" for indoor tanning services includes all amounts paid, including payments made using insurance (unless exempt under the phototherapy services rules).

- Cite: § 5000B(a); § 49.5000B-1(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-1(e)(1)

Example: A customer with insurance receives \$18 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-1(e)(3)

## **F. Refunds, Penalties, and Procedure**

### **F.1. 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 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-1(e)(1)

In the case of an undesignated payment card, the indoor tanning tax is collected when the undesignated payment card is redeemed, in whole or in part, to pay for indoor tanning services - that is, when an amount is paid is for indoor tanning service. If the undesignated payment card is never used, or used for products or services that are not indoor tanning services, no indoor tanning tax is collected. In such a case a refund of the indoor tanning tax is not allowed.

### **F.2. Penalties**

Consult the following Internal Revenue Manual sections for information about penalties applicable to the indoor tanning 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 tax is subject to the above-listed excise penalties, which includes delinquency penalties under § 6651(a)(1) for failure to file, and § 6651(a)(2) for failure to pay.

The indoor tanning 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 § 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.

### **F.3. 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 § 7501. For the indoor tanning tax, the Form 872-B should specify the following:

The amount of liability for collecting and remitting § 5000B, Indoor tanning tax, imposed on the taxpayer(s) by § 7501.

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-1(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 § 5000B and § 49.5000B-1 (e)(3). The Form 872-B should specify the following:

The amount of liability for remitting § 5000B, Indoor tanning tax, imposed on the taxpayer(s) by § 5000B and § 49.5000B-1(e)(3).

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 §§ 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.

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

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

### **F.4. Collected Tax – Secondary Liability**

The indoor tanning tax is a collected tax and the person receiving payment for the services must collect the tax. Cite: § 5000B(c)(3); § 49.5000B-1(f). 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-1 (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.

## **F.5. Collected Tax – IRC Section 6672 Trust Fund Penalty**

Because the indoor tanning tax is a collected tax, the assessable penalty of § 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 § 6672 penalty as outlined in IRM 4.24.9. 4.

## **II. Examination Techniques**

### **A. Objectives**

The objectives of this chapter are:

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

### **B. 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 and retail gas stations. In these cases, the indoor tanning services might not be advertised and therefore might 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.

### **C. 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 section 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).

### **C.1. Undesignated Payment Cards**

One situation that requires special attention is the payment for undesignated payment cards because 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 reflecting 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 you 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.

### **C.2. "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. In this situation the indoor tanning services are not free since the services are conditioned on buying non-indoor tanning goods or services. Therefore, tax on the portion of the payment representing the amount paid for indoor tanning services must be determined. Compute the tax after determining the value of the indoor tanning services (see section 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," section 1.

The tax does not apply to indoor tanning services that are provided free of charge. Indoor tanning services are provided free of charge if no one pays anything of value

to the provider of the service for the indoor tanning services and is not conditioned on making another payment or purchase. Thus, for example, tax is not imposed on the redemption of a promotional coupon for indoor tanning services if the coupon is provided at no cost and at no obligation to purchase anything. If indoor tanning services are provided at a reduced rate the tax applies to the amount actually paid for the indoor tanning services. Cite: §49.5000B-1(d)(1)(ii).

### **C.3. Other Fees**

A common situation in the tanning industry is for the provider to charge joining, registration, enrollment, freeze or similar fees; as explained below, these fees are taxable. Usually, these fees are charged in conjunction with a monthly fee for the right of the payor to receive indoor tanning services. Typically, the monthly fee is lower than if the tanning services were billed for each individual indoor tanning services session.

Various benefits may accrue to the payor of these fees such as receiving a discounted monthly price, discounts on other goods or services, allowing certain methods of payment, such as Electronic Funds Transfer, i.e., debit drafts to the payor's account, or other benefits.

The indoor tanning services provider may charge freeze and unfreeze fees. These fees may allow the customer to skip one or more monthly payments without being charged a fee when restarting the service. It may also waive any contractual obligation regarding termination fees or may provide other benefits such as preserving the original monthly plan price. As discussed below, these freeze fees are taxable.

Fees for starting, joining, registering, enrolling, and similar fees paid to a provider to join a monthly (or other periodic) membership program that provides indoor tanning services are amounts paid for indoor tanning services. Similarly, amounts paid to a provider that temporarily suspend a periodic membership program are amounts paid for indoor tanning services. Cite: §49.5000B-1(d)(1)(iv).

Note that the rules for determining the portion of revenue reasonably attributable to indoor tanning services also apply to a fee if that fee is applicable to a bundle of indoor tanning services and other goods or services.

### **C.4. Red Light Beds**

Some tanning salons offer "red light" bed tanning sessions. A red light bed that employs lamps that do not emit ultraviolet radiation with wavelengths in air between 200 and 400 nanometers are not taxable for the purpose of the indoor tanning services tax. If the lamps in these beds do not emit ultraviolet radiation within the field of nanometers subject to tax, then a service that uses such 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 tax. Ensure that a bed labeled "red light" in fact does not use bulbs or lamps emitting ultraviolet radiation with wave lengths subject to tax.

## **C.5. Tanning Providers May Receive Revenue from Group Buying Programs**

Indoor tanning services providers may receive indoor tanning services payments from group buying programs such as Groupon, Living Well, BuyWithMe, Yipit, and various other regional or local based programs. These programs operate by offering reduced prices for goods and services and share the proceeds with the service provider. Tanning payments received from these services are subject to tax because the indoor tanning service tax applies to all amounts paid for indoor tanning service. Ensure that the tanning provider accounts for indoor tanning services payments received from these programs. If the service provider did not properly account for the payments received from these programs, then additional tax may be due. In these circumstances, the indoor tanning tax should be computed by multiplying the amount received, x .09091 to determine the amount of Federal Excise Tax on the transaction. ( $1.10 \times .10 = .09091$ )

## **C.6. Franchise Operations**

If the indoor tanning operator is a franchise, ensure that computations for determining the amount reasonably attributable to indoor tanning services (or any other determination required) are based upon data derived from the taxpayer's business operations and not standard rates which do not conform to the franchisee's business experience.

## **C.7. Multiple Business Locations**

Some indoor tanning services providers may have several tanning salon locations operating under separate EINs. Because each location with an EIN must separately file Forms 720 and pay over the indoor tanning tax, you should be aware of different possible scenarios when a provider operates multiple business locations. One scenario is when one entity/location is filing but none of the other entities/locations are filing. Another scenario occurs when you're contacting a non-filer. Be aware that the provider may have other entities/locations that also are non-filers. As a result, always inquire whether the provider operates other locations.

## **C.8. Tanning Banks**

Some tanning providers allow customers to deposit funds into a "tanning bank." This is provided as a convenience when the customer may not have cash, debit, or credit cards with them. The customer may draw upon these funds to pay for a tanning session or a session upgrade, or for various products or non-tanning spa services. The tanning bank is similar to a gift card. When the funds are withdrawn from the tanning bank to pay for indoor tanning services, a taxable transaction occurs. For example, if a customer deposits \$50 into a tanning bank on April 1, and applies \$20 to an indoor tanning session or upgrade on July 1, the \$20 is subject to

10 percent federal excise tax in the amount of \$2, and it is reported on the third quarter Form 720.

## **D. Excise Examination**

### **D.1. 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.

### **D.2. 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.

### **D.3. Reconcile Return to Books/Records**

(1) 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 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.

### **D.4. 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 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.

## **D.5. 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 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 tax collected by the provider).

### Indirect Methods

Indirect methods include:

- Secure the taxpayer's sales tax returns. Determine what goods and services sold by the taxpayer are subject to the sales tax and how each category is reported. Reconcile the revenue reported for sales tax purposes to that reported for indoor tanning services.

- Monitoring of hours via a meter or counter on a tanning bed. To employ this method:
- Count the hours that each bed was used for a month or quarter.
- Divide the total number of tanning hours by the amount determined by multiplying the average time per tan by the average charge per tan.
- If this calculation is performed for a month rather than a quarter, extrapolate for a quarter by multiplying the month amount by 3.
- 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 section 1.
- Electricity usage. Look for usage inappropriately low 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.

#### Bank Deposits/Electronic Funds Transfers (EFTs)

Tanning salons are moving toward receiving their fees by charging debit and credit cards. This is a business model 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 to account 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 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:

- Customer visits your web site and chooses to buy your product/service.
- Customer completes an order form on your web site, securely providing credit card or check info.
- Completed form is submitted to our secure server for verification.
- You receive real-time online authorization from our server.
- Order confirmation is immediately sent to you and to customer.
- Customer's credit card or checking account is debited; your bank account is credited.
- The transaction appears on customer's credit card or checking account statement.

Determine the taxpayer's method of accounting for rejected EFT drafts that are subsequently paid for by the customer. A reconciliation of the indoor tanning services tax payable account may show whether these payments are being included in the indoor tanning revenue. Ask the taxpayer to walk you through the entire accounting process of EFTs, including rejected drafts and subsequent payments.

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.

## **D.6. 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 primarily 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.

## **D.7. 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.

You can access the fraud indicator check sheet via IRM Section 25.1.11, Exhibit 25.1.11-1.

A more complete listing of all indicators of fraud: IRM 25.1.2.3

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

## **D.8. IDR Language**

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.

Provide the manufacturer and model of each tanning station at each location.

Provide the number of employees at each indoor tanning service location. Form 941, Employer's Quarterly Federal Tax Return, for the period(s) ending (fill in date here) should be available for inspection.

Describe all service delivery options offered, including bundled services, unlimited tanning services, and any other methods.

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 (fill in date here).

Sales invoices/receipts for the period(s) ending (fill in date here) should be available for review.

Provide printouts of General Ledger account for excise tax payable for period(s) ending (fill in date here).

Electric utility bills for period(s) ending (fill in date here) should be available for review for each location.

List all situations in which you did not collect excise tax on indoor tanning services and explain why you did not collect the tax.

Records of tanning station usage for the examination period(s) should be available for review.

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).

Provide a sample of all documents used in recording the indoor tanning tax from the customers receipt through journals, ledger, commercial or other record keeping system.

Explain how payments for undesignated payment cards (for example, gift cards or certificates) are recorded.

Provide copies of all business and personal bank account statements for the period(s) ending (fill in date here).

For Qualified Physical Fitness Facilities

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

## **D.9. Frequently Asked Questions**

View FAQs via the IRS.gov Indoor Tanning Services Tax Center | Internal Revenue Service (irs.gov)

## **D.10. Link to Regulation 49.5000B-1T**

[Regulation 49.5000B-1T](#) (PDF)