



*Affordable Care Act: The Number of  
Taxpayers Filing Tanning Excise Tax Returns  
Is Lower Than Expected*

**September 22, 2011**

**Reference Number: 2011-40-115**

This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.

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Phone Number | 202-622-6500

Email Address | [TIGTACommunications@tigta.treas.gov](mailto:TIGTACommunications@tigta.treas.gov)

Web Site | <http://www.tigta.gov>



## HIGHLIGHTS

### **AFFORDABLE CARE ACT: THE NUMBER OF TAXPAYERS FILING TANNING EXCISE TAX RETURNS IS LOWER THAN EXPECTED**

## Highlights

**Final Report issued on  
September 22, 2011**

Highlights of Reference Number: 2011-40-115 to the Internal Revenue Service Commissioners for the Small Business/Self-Employed Division and the Wage and Investment Division.

### **IMPACT ON TAXPAYERS**

The Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act were signed into law in March 2010. This legislation contains revenue provisions anticipated to generate \$438 billion in the form of new taxes, fees, and penalties. One of these new taxes is an excise tax on indoor tanning services (tanning tax) which became effective on July 1, 2010, and is 10 percent of the amount paid for tanning services. The tax is paid by the person receiving the service and is collected by the service provider. The tanning tax is due and payable quarterly.

### **WHY TIGTA DID THE AUDIT**

This audit was initiated because the tanning tax was a new provision in the law that became effective soon after passage, which increased the potential risks involved with implementation. It has been estimated that there could be about 25,000 tanning businesses affected by the tax. The objective of our audit was to determine whether the Internal Revenue Service (IRS) effectively implemented this tax.

### **WHAT TIGTA FOUND**

The IRS developed an outreach plan, updated the excise tax form and instructions, and made preparations for receiving and processing tax returns with the tax. The IRS also developed a plan for dealing with noncompliance, including initiating audits and issuing notices to taxpayers who may potentially owe the tax.

The number of taxpayers filing tanning services excise tax returns is much lower than expected. According to IRS documents, in April 2010, the Indoor Tanning Association estimated that 25,000 businesses were providing indoor tanning services. However, the actual number of businesses liable for the tax has been difficult to determine with any degree of accuracy. Identifying these taxpayers has been one of the more challenging tasks the IRS has faced when implementing this provision. For the first three applicable quarters, the number of Federal excise tax forms reporting tanning taxes has averaged approximately 10,300.

The IRS could have taken more timely actions to contact taxpayers who may owe the tax. By the time notices were issued, tanning excise tax returns had been due for three quarters. Late filing of these returns would result in the taxpayer owing the unpaid tax, plus interest and penalties. In addition, the information used to identify these taxpayers appears incomplete. Furthermore, TIGTA advised the IRS that the notice did not contain some pertinent information. The IRS added this information before mailing.

Finally, the publication containing information about excise tax requirements was not updated until more than a year had passed since the provision became effective.

### **WHAT TIGTA RECOMMENDED**

TIGTA recommended that the IRS perform further analyses of the data sources used, including records with incomplete address information, to determine whether a large number of tanning businesses were not identified, monitor the results from the notice mailing to determine whether additional data sources are warranted, and update the excise tax publication to include tanning tax information.

In their response to the report, IRS officials agreed with our recommendations. The IRS plans to perform the analysis suggested, monitor the results of the notice mailing, and consider additional actions based on the results. The excise tax publication was revised in July 2011 to include tanning tax information.



TREASURY INSPECTOR GENERAL  
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

September 22, 2011

**MEMORANDUM FOR** COMMISSIONER, SMALL BUSINESS/SELF-EMPLOYED  
DIVISION  
COMMISSIONER, WAGE AND INVESTMENT DIVISION

*Michael R. Phillips*

**FROM:**

Michael R. Phillips  
Deputy Inspector General for Audit

**SUBJECT:**

Final Audit Report – Affordable Care Act: The Number of Taxpayers  
Filing Tanning Excise Tax Returns Is Lower Than Expected  
(Audit # 201140001)

This report presents the results of our review to determine whether the Internal Revenue Service (IRS) effectively implemented the excise tax on the indoor tanning services provision of the Patient Protection and Affordable Care Act<sup>1</sup> legislation. This audit is included in our Fiscal Year 2011 Annual Audit Plan and addresses the major management challenge of Implementing Health Care and Other Tax Law Changes.

Management's complete response to the draft report is included in Appendix V.

Copies of this report are also being sent to the IRS managers affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions or Michael E. McKenney, Assistant Inspector General for Audit (Returns Processing and Account Services), at (202) 622-5916.

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<sup>1</sup> Pub. L. No. 111-148, 124 Stat. 119 (2010).



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*Abbreviations*

IRS

Internal Revenue Service

NAICS

North American Industry Classification System



## *Affordable Care Act: The Number of Taxpayers Filing Tanning Excise Tax Returns Is Lower Than Expected*

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### *Background*

On March 23, 2010, the Patient Protection and Affordable Care Act<sup>1</sup> (Affordable Care Act) was signed into law. Along with amendments in the Health Care and Education Reconciliation Act of 2010,<sup>2</sup> which was signed on March 30, 2010, this legislation contains revenue provisions anticipated to generate \$438 billion<sup>3</sup> in the form of new taxes, fees, and penalties. One of these new taxes is an excise tax on indoor tanning services (referred to hereafter as the tanning tax).<sup>4</sup>

Excise taxes are levied on a wide variety of goods, services, and activities. They may be imposed at the time of sale by a manufacturer or retailer or at the time a service is rendered to a consumer. Many of the taxes are set aside into trust funds earmarked for related capital projects, such as highway and airport improvements. Excise taxes are independent of income taxes and are reported separately.

This new excise tax applies to indoor tanning services paid for on or after July 1, 2010, and is 10 percent of the amount paid for the tanning services. Indoor tanning services are defined as services using ultraviolet lamps to induce skin tanning. There are other services provided by tanning salons that are excluded from the tanning tax. It does not apply to 'spray' tans or topical creams or lotions. In addition, it does not apply to phototherapy services performed by licensed medical professionals, during which individuals are exposed to light for the treatment of certain medical conditions. Tanning services are not taxable when provided by qualified physical fitness facilities (such as a workout facility or gym). The fitness facility must meet various tests to be exempt.



Liability for the tax arises at the time of payment for services, and the tax is collected by the service provider from the person paying for the indoor tanning services. The tax is then reported and paid to the Internal Revenue Service (IRS) using the Quarterly Federal Excise Tax Return (Form 720). Because the tanning tax became effective on July 1, 2010, the end of the first quarterly period was September 30, 2010. The due date for these quarterly returns is generally 1 month after the end of the reporting period, or October 31, 2010, for the first quarter the tax

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<sup>1</sup> Pub. L. No. 111-148, 124 Stat. 119 (2010).

<sup>2</sup> Pub. L. 111-152, 124 Stat. 1029.

<sup>3</sup> Joint Committee on Taxation estimated revenue effects, JCX-17-10, March 20, 2010.

<sup>4</sup> P.L. 111-148, Section 5000B.



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was required to be reported. The return can be filed early if the entity is going out of business. An Employer Identification Number is required to file these returns.

This review was performed at the Fresno Campus<sup>5</sup> in Fresno, California, during the period September 2010 through June 2011. It included a review of Forms 720 filed nationwide and discussions with IRS personnel assigned to the Small Business/Self-Employed Division Headquarters in Lanham, Maryland, and the Wage and Investment Division Headquarters in Atlanta, Georgia. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

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<sup>5</sup> The data processing arm of the IRS. The campuses process paper and electronic submissions, correct errors, and forward data to the Computing Centers for analysis and posting to taxpayer accounts.



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## *Results of Review*

### ***Immediate Steps Were Taken to Implement the Excise Tax on Indoor Tanning Services***

Because the tanning tax went into effect soon after the law was signed (approximately 3 months after enactment),<sup>6</sup> it was imperative that the IRS quickly prepare for its implementation. The IRS assessed the provision and determined what overall actions were needed, broke them down into specific action items, and tracked the status of the items in a computer system dedicated to implementation of new laws. These action items and the general status of the implementation of the various Affordable Care Act provisions were monitored by an Executive Steering Committee, which met weekly.

#### ***The IRS developed an outreach plan for taxpayers who may owe the tax***

As part of the implementation of the tanning tax, the IRS developed an outreach plan. Because the tax was aimed at a specific taxpayer population, the IRS was able to target the associated outreach accordingly. Information regarding the new filing requirements was disseminated in many different forms, including:

- Adding information to the IRS web site ([www.IRS.gov](http://www.IRS.gov)).
- Hosting live webinars and uploading videos on the YouTube web site<sup>7</sup> ([www.youtube.com](http://www.youtube.com)).
- Outreach to industry associations.
- Contacting State licensing bureaus.
- Issuing electronic bulletins to tax professionals.
- Giving seminars at the Nationwide Tax Forums.

#### ***Forms and instructions were updated accurately and timely to assist taxpayers with filing***

Although general outreach related to the tanning tax was important, it was also vital to update the actual forms and instructions required to report the tax. Accordingly, the IRS revised

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<sup>6</sup> The law was enacted on March 23, 2010, and the Tanning Tax provision became effective on July 1, 2010. As of this date, service providers were required to begin collecting the tax.

<sup>7</sup> YouTube is a video-sharing web site on which users can upload, share, and view videos.





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Form 720 and the associated instructions to reflect the tax. These revisions included an additional line added to the Form 720 and a paragraph describing the tax in the ‘What’s New’ section on the first page of the instructions. The revised Form 720 instructions also included three paragraphs devoted to the tanning tax (see excerpt, right). This information accurately reflected the statute and regulations and appeared sufficient to enable a taxpayer to file an accurate return.

The revisions were completed in July 2010, which was early enough for taxpayers to obtain them for information prior to filing. While the tax became effective July 1, the first returns were not due until October 2010. Taxpayers could have filed earlier if they were going out of business. However, there would likely have been very few entities that went out of business in the first few weeks of July after the tax went into effect and before the revised Form 720 and associated instructions were updated.

### **Indoor Tanning Services Tax**

#### **Indoor tanning services (IRS No. 140).**

For indoor tanning services paid for after June 30, 2010, the tax is 10% of the amount paid. The tax is paid by the person paying for the indoor tanning services and is collected by the person receiving payment for the indoor tanning services.

#### **Who Must File**

The person receiving the payment for indoor tanning services (collector) must collect and submit the tax and file the return. If the collector does not collect the tax for any reason, the collector is liable for the tax. Enter the amount of tax collected (or due from the collector for failing to collect the tax) for the quarter.

#### **Definition of indoor tanning services.**

Indoor tanning service 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. The term does not include phototherapy service performed by, and on the premises of, a licensed medical professional (such as a dermatologist, psychologist, or registered nurse). See regulations section 49.5000B-1T for more information.

### **Tax return processing systems were updated to enable accurate processing of returns reporting the tanning tax**

There was a relatively short time period to prepare for receipt and processing of returns reporting the tanning tax. Accordingly, the IRS had to immediately update the computer systems used for processing tax returns.

The IRS receives both paper and electronically transmitted returns. While the basic processing of these returns is similar, there are different computer systems required to accomplish this. The IRS successfully updated these computer systems to enable both types of returns to be accepted and processed timely. In general, the systems had to be updated to include a new abstract code for the tanning tax, which is a unique number assigned to each of the excise taxes. We reviewed documentation for the electronic return processing system that accepts and validates electronic return information and determined that the new abstract code had been added to the system.

In order to verify that the paper return processing system was updated, we reviewed a sample of returns reporting the tanning tax and determined whether they were being processed accurately. Because we wanted to identify potential systemic problems, we selected a judgmental sample of 24 Forms 720 filed with the tanning tax that were processed through October 31, 2010. For each return, we matched certain information on the tax return against that which posted to the



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taxpayer's account. This information included business name and address information as well as the reported tax amount. We did not identify any issues or discrepancies.

### ***The Number of Tanning Excise Tax Returns Is Much Lower Than Expected***

According to IRS documents, in April 2010 the Indoor Tanning Association estimated that 25,000 businesses were providing indoor tanning services, including approximately 15,000 stand-alone tanning salons and approximately 10,000 other businesses that offer tanning services, such as spas, health clubs, and beauty salons.<sup>8</sup> Prior to the enactment of the tanning tax provision, the number of excise tax returns filed was approximately 25,000 per quarter, so it appeared this new tax had the potential to double the number of Forms 720 filed.<sup>9</sup> However, the actual number of businesses liable for the tax has been difficult to determine with any degree of accuracy; therefore, this estimate should be used with caution. Identifying these taxpayers has been one of the more challenging tasks the IRS has faced when implementing this provision.

However, if this estimate is used as a general baseline, it is apparent that compliance with the provision is much lower than expected. For the first three applicable quarters, the number of Forms 720 reporting tanning taxes has averaged close to 10,300.

***Figure 1: Excise Tax Returns Filed With the Tanning Tax***

Quarter (period ended)	Returns Filed	Tanning Tax Reported
September 30, 2010	10,665	\$17.8 million
December 31, 2010	10,677	\$15.7 million
March 31, 2011	9,628	\$20.9 million

*Source: The IRS's Compliance Data Warehouse: Forms 720 reporting tanning tax filed as of July 26, 2011.*

The Congressional Joint Committee on Taxation estimated this tax would raise less than \$50 million in the last 3 months of Fiscal Year 2010 and raise \$200 million for Fiscal Year 2011. However, as indicated above, the returns and associated receipts have been lower than expected, so the amount projected for Fiscal Year 2011 may not be reached. However, receipts could increase over time as more taxpayers become aware of the tax and come into compliance.

<sup>8</sup> In a July 11, 2011, Bloomberg.com article, the Indoor Tanning Association stated that due to the weak economy and the tanning tax, the number of tanning salons in the United States had decreased.

<sup>9</sup> The estimated number of indoor tanning businesses does not necessarily equate to the required number of filers. A business entity with multiple tanning locations may only be required to file one excise tax return.



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**The IRS made plans to address compliance issues, but more timely action was needed**

Although most taxpayers voluntarily pay the taxes that are due by law, the IRS has to have a plan to deal with those who do not. Two primary forms of noncompliance include underreporting (not reporting one's full tax liability on a timely filed return), and nonfiling (not filing required returns on time and not paying the full amount of tax that should have been shown on the required return). To effectively administer the tax code, the IRS has to take specific actions to address these situations. In the case of the tanning tax, this is complicated by the fact that it is a new tax, so some taxpayers may not be aware of their obligations. To illustrate this further, an IRS document describing compliance challenges states, "The tax is new and unusual for this industry, which has never experienced the imposition of a Federal excise tax on tanning services, and thus the overwhelming majority have never filed an excise tax return."<sup>10</sup>

To meet these challenges, the IRS developed a compliance plan that addresses both underreporting and nonfiling. To obtain information pertaining to underreporting, the IRS plans to audit a number of excise tax returns reporting the tanning tax. Information from these audits will enable the IRS to refine its methods to identify and address underreporting.

With regard to nonfiling, the IRS recognized that some taxpayers who had not filed required returns may have simply been unaware of the new tax rather than willfully ignoring the law. Accordingly, on June 2, 2011, the IRS issued notices to approximately 14,000 taxpayers who were identified through various data sources as potentially owing the tax but had not filed a Form 720 during the third or fourth quarters of Calendar Year 2010. These notices informed the taxpayer that it appeared they may owe the tax, provided background information, and then asked for a response as to why the taxpayer believes they are not liable. An example of this notice is provided in Appendix IV. Although we agree with this approach in general, we believe it should have been taken sooner. Because the tanning tax was a brand new tax imposed on a group of taxpayers with no previous experience with excise taxes, it was imperative that the IRS attempt to inform taxpayers of their filing responsibilities and bring them into compliance in a timely manner.

Initially, the IRS researched ways to identify these taxpayers using information available internally. One source, the North American Industry Classification System (NAICS),<sup>11</sup> is a code used to identify industry segments. However, this code is not required to be provided on filed tax returns, and further research indicated it could not be relied upon. Furthermore, broad searches by business name were not deemed effective because many of these businesses do not

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<sup>10</sup> The IRS's Compliance Initiative Project Part Two – Indoor Tanning Tax Compliance Initiative, approved September 27, 2010.

<sup>11</sup> The NAICS is used by business and government to classify business establishments according to type of economic activity. The NAICS numbering system employs a code with up to six digits to designate specific industries.



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have 'tan' or 'tanning' in their name. Accordingly, as early as April 2010, the IRS was planning to contact State governments for tanning data. However, obtaining and formatting data from the two external sources selected (State licensing bureau data and a commercial business listing) was not completed until May 2011, more than 1 year later.

There were various reasons for this delay. The IRS Excise Tax Office devoted limited resources to the effort. Only one full-time employee performed the bulk of the data manipulation (although other employees assisted at various stages).<sup>12</sup> In addition, there was a considerable amount of time needed to obtain and format data from 18 different State licensing bureaus, although this should have been anticipated by the IRS. Moreover, the commercial business listing was always available and could have been obtained and utilized earlier in the process.

By the time the combined data were used to issue notices to potential nonfilers in early June 2011, the due dates for three quarters of returns had passed. Taxpayers who owed the tanning tax and were not aware of the filing requirement would have then had three delinquent returns due, along with the associated tax, interest, and penalties. In addition, if the taxpayers had not been collecting the tax from their customers, they would also owe the tax out-of-pocket, possibly affecting the viability of their business.

### **The data used to identify nonfilers appear to be incomplete**

As indicated above, the IRS obtained external data from two sources, State licensing bureaus and a commercial business listing. The steps the IRS took to manipulate and format the data were logical and appropriate and included matching the databases against information on IRS computers to obtain the Employer Identification Number for each taxpayer, as well as eliminating duplicates. However, the end product appears to be missing many tanning businesses:

- After the various data manipulation steps were completed, the result was approximately 19,000<sup>13</sup> unique taxpayers with potential tanning businesses, well below the 25,000 tanning businesses estimated by the Indoor Tanning Association.
- Approximately 7,000 of the 10,000 taxpayers (70 percent) who had filed tax returns reporting the tanning tax in the third or fourth quarters of Calendar Year 2010 did not appear in the externally obtained data.

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<sup>12</sup> According to the IRS, two Computer Audit Specialists, a Program Analyst, and a Computer Assistant provided support and assistance.

<sup>13</sup> The commercial business listing contained approximately 21,000 tanning businesses. After eliminating duplicates, there were approximately 19,000 unique taxpayers, approximately 2,000 of which had incomplete or inaccurate address information, and approximately 3,000 of which had filed tax returns. The balance of approximately 14,000 taxpayers had not filed a Form 720 reporting the tanning tax and were sent notices.



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- Notices were not mailed to approximately 2,000 taxpayers identified by these data sources due to incomplete or inaccurate address information.

The IRS indicated that obtaining external industry data and mailing notices was only the first step in a continuing effort to identify nonfilers and bring them into compliance, and the data were not expected to contain the full population of taxpayers potentially owing the tanning tax. However, it appears more could be done to determine why so many taxpayers were not included in the initial external data. Depending on the results of the notice mailing, obtaining data from other sources may be warranted.

### ***Recommendations***

The Director, Small Business/Self-Employed Specialty Programs, should:

**Recommendation 1:** Perform further analyses of the data sources used, including the records with incomplete address information, and determine whether a large number of tanning businesses were not identified.

**Management's Response:** IRS management agreed with this recommendation and will perform the analysis suggested.

**Recommendation 2:** Monitor the results from the notices sent to taxpayers who could potentially owe the tanning tax and, if results warrant, consider obtaining additional data sources for compliance use.

**Management's Response:** IRS management agreed with this recommendation and indicated that this was the intent of the notice program the IRS developed. The IRS will consider additional actions according to the results.

### ***Some Information Provided to Taxpayers Was Delayed or Required Improvement***

As discussed previously, the IRS provided tanning tax information to taxpayers through a wide variety of methods. However, a significant publication related to excise taxes was delayed for a long period of time, and the notice that was issued to taxpayers required improvement.

#### **The publication with excise tax information was not updated at the same time as Form 720 and its instructions**

More than 1 year after the passage of the legislation providing for the tanning tax, Excise Taxes (Publication 510) had not been updated to include tanning tax information. The updated Publication 510 was finally issued in July 2011.



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Information should be provided to taxpayers in a timely manner in order to assist them with meeting their tax obligations. This is especially true of new taxes imposed on a unique population of taxpayers who historically have not had to pay excise taxes and who may not have any experience with them.

One contributing factor for the delay was that the IRS waited until Congress passed legislation in late Calendar Year 2010 affecting other excise tax credits and the IRS did not want to have to update the publication twice in a relatively short period of time. However, the publication was not updated until July 2011, more than 6 months after the passage of the other legislation. The IRS also stated that this publication does not have a specified update schedule like most other publications (e.g., annually) and that it is a lower priority compared to updating forms and instructions.

Because this publication did not contain current information, taxpayers could not use it as a source of information for the proper reporting of this new tax, even though more than a year had passed since its enactment. Therefore, a taxpayer who consulted the publication for information may have reached the wrong conclusion related to whether the tax is applicable.

**The notice to be issued to potential nonfilers did not contain pertinent information**

The notice to be issued to potential nonfilers did not contain pertinent information regarding the possible exemptions to the tax. It did not include information about the qualified physical fitness facility exemption allowed by IRS regulations. This notice is intended as a compliance tool to encourage taxpayers to file (if required) or to enable the IRS to determine that the taxpayer is not subject to the tax. To serve this purpose, it should contain sufficient information to enable the taxpayer to make this determination with minimum burden. This would include providing an overview of the most important aspects of the law. We could not specifically determine why the IRS did not include all the important tax information in the notice. It appears that the IRS relied upon references to other specific information sources, such as the Form 720 instructions and the IRS web site, to sufficiently inform taxpayers about the tax.

Some physical fitness facilities offer tanning services and would be exempt from the tax. Providing specific information regarding this exemption would enable taxpayers to resolve the issue more effectively and with minimum burden.

We reported our concerns to the IRS and it took immediate corrective action. The draft notice was revised in response to our concerns. Information related to the qualified physical fitness facility exemption was included in the background information, and a specific response item in the questionnaire portion of the notice was added to indicate whether the taxpayer was claiming this exemption. We consider this revision sufficient to address our concerns.





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***Recommendation***

**Recommendation 3:** The Commissioner, Wage and Investment Division, should ensure that Publication 510 is updated to include information related to the excise tax on indoor tanning services.

**Management's Response:** IRS management agreed with this recommendation and has already revised Publication 510, Excise Taxes, to include information concerning the Indoor Tanning Tax as of July 15, 2011.



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## **Appendix I**

### *Detailed Objective, Scope, and Methodology*

Our overall objective was to determine whether the IRS effectively implemented the excise tax on the indoor tanning services provision of the Patient Protection and Affordable Care Act<sup>1</sup> (Affordable Care Act). To accomplish this objective, we:

- I. Determined whether adequate preparations were made to ensure affected service providers were notified of the tanning tax and its filing requirements.
  - A. Assessed the adequacy of actions taken to identify the service provider population affected by the tanning tax.
    1. Reviewed the effectiveness of IRS actions to identify affected service providers.
    2. Determined whether we could identify the population using tax information available to the Treasury Inspector General for Tax Administration and any other data sources.
    3. Identified what data files and fields were available (name, NAICS code, etc.) and if they could be used to identify affected taxpayers.
    4. Determined whether any actions were taken to mark the accounts of service providers subject to the tanning tax. We determined whether a specific NAICS code, or other type of indicator, could be implemented specific to tanning salons.
  - B. Reviewed the feasibility of the IRS communicating the new filing requirements directly to the population of affected service providers.
    1. Reviewed the information used to make the decision to not communicate directly with affected service providers during the initial implementation of the action plan and determined whether it justified this decision.
    2. Determined whether a mass-mailed postcard would be feasible to inform the affected service providers of filing requirements.
  - C. Assessed the timeliness and accuracy of other outreach efforts related to the tanning tax.
    1. Obtained a copy of the overall outreach plan.

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<sup>1</sup> Pub. L. No. 111-148, 124 Stat. 119 (2010).





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2. Performed a cursory review of each type of outreach effort in the plan for adequacy.
  3. Analyzed the plan and determined whether any outreach opportunities were missed in the plan.
- D. Determined whether forms, instructions, and publications related to the tanning tax were updated adequately and timely.
1. Identified which forms, instructions, and publications were affected by the tax.
  2. Reviewed each for the adequacy of the information in relation to the statute and regulations and to determine whether they were updated in a timely fashion.
  3. Determined the cause for why items were not updated timely and the potential effect on taxpayers.
- II. Determined whether the IRS adequately prepared for the processing of tax returns reporting the tanning tax and whether it adequately monitored the actual receipts and processing of these returns.
- A. Determined whether the IRS updated the processing systems for paper and electronic tax returns so that it could accept and process returns reporting the new tax. We performed a cursory review of the actions taken to update these systems.
- B. Determined whether filed returns reporting the tanning tax were posted accurately.
1. Using data obtained in step II.C.3, identified a judgmental sample of 24 returns reporting the tanning tax<sup>2</sup> that were processed during the first 3 weeks of October 2010. These returns were selected from a total of 117 returns processed during this period.
  2. Matched the entity and tax information on the sample returns against the posted data.
- C. Determined whether the IRS adequately planned for the increase in returns and whether it timely monitored the volume of returns filed reporting the tanning tax.
1. Held discussions with IRS Excise Tax Program officials to determine what planning assumptions were made regarding the volume expected and what additional resources were committed.

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<sup>2</sup> Requested 48 of the first 117 Quarterly Federal Excise Tax Returns (Form 720) filed for the third quarter (July 1, 2010, thru September 30, 2010) and reviewed the first 24 returns received.



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2. Held discussions with IRS Excise Tax Program officials regarding what steps were taken to monitor the volumes of incoming returns, and obtained copies of the weekly volume reports.
  3. Identified and downloaded return information from Forms 720 posted each week with Abstract Code 140<sup>3</sup> using data obtained from the Treasury Inspector General for Tax Administration Data Center Warehouse.<sup>4</sup> We validated the accuracy of the data by reviewing the data for discrepancies and formatting errors.
  4. Matched our data against IRS production reports showing total receipts of Form 720 with the tanning tax and reviewed for discrepancies.
- III. Determined whether the IRS developed an adequate plan to bring nonfilers into compliance with the law.
- A. Reviewed the adequacy of IRS actions related to tanning tax compliance.
    1. Obtained and reviewed the Compliance Initiative Project information to determine if it will effectively bring service providers into compliance.
    2. Obtained and reviewed the notice to be issued to potential nonfilers to determine if it would be effective for educating service providers.
  - B. Identified the population the IRS used for the compliance actions described above and if it appeared adequate for this purpose.

**Internal controls methodology**

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined the following internal controls were relevant to our audit objective: the IRS's planning and outreach efforts to ensure the tanning tax was collected and the associated tax returns were accurately and timely filed, actions to ensure these returns were able to be accepted and processed, and actions taken to ensure taxpayers are filing required returns and paying the correct amount of tax.

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<sup>3</sup>An abstract code is a unique number assigned to each of the excise taxes. Abstract Code 140 identifies the indoor tanning excise tax.

<sup>4</sup> The Data Center Warehouse is a collection of IRS databases containing various types of taxpayer account information that is maintained by the Treasury Inspector General for Tax Administration for the purpose of analyzing data for ongoing audits.



*Affordable Care Act: The Number of Taxpayers  
Filing Tanning Excise Tax Returns Is Lower Than Expected*

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**Appendix II**

*Major Contributors to This Report*

Michael E. McKenney, Assistant Inspector General for Audit (Returns Processing and Account Services)

Kyle R. Andersen, Director

Richard J. Calderon, Audit Manager

Roy E. Thompson, Audit Manager

Steven D. Stephens, Lead Auditor

Laura Paulsen, Auditor

Mark V. Willoughby, Auditor



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**Appendix III**

*Report Distribution List*

Commissioner C  
Office of the Commissioner – Attn: Chief of Staff C  
Deputy Commissioner for Services and Enforcement SE  
Deputy Commissioner, Small Business/Self-Employed Division SE:S  
Deputy Commissioner of Operations, Wage and Investment Division SE:W  
Director, Communications, Liaison, and Disclosure, Small Business/Self-Employed Division  
SE:S:CLD  
Director, Customer Account Services, Wage and Investment Division SE:W:CAS  
Director, Customer Assistance, Research & Education, Wage and Investment Division  
SE:W:CAR  
Director, Specialty Programs, Small Business/Self-Employed Division SE:S:SP  
Director, Media and Publications, Wage and Investment Division SE:W:CAR:MP  
Director, Submission Processing, Wage and Investment Division SE:W:CAS:SP  
Chief Counsel CC  
National Taxpayer Advocate TA  
Director, Office of Legislative Affairs CL:LA  
Director, Office of Program Evaluation and Risk Analysis RAS:O  
Office of Internal Control OS:CFO:CPIC:IC  
Audit Liaisons:  
    Commissioner, Small Business/Self-Employed Division SE:S  
    Chief, Program Evaluation and Improvement, Wage and Investment Division  
    SE:W:S:PEI



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**Appendix IV**

*Example of Notice Sent to Taxpayers*

**Internal Revenue Service**

GENERAL TANNING SALON  
222 Main St  
Anytown, PA 99999-9999

**Department of the Treasury**

Date:  
June 2, 2011  
Taxpayer Identification Number:  
11-1111111  
Form:  
720  
Tax Period(s) Ended:  
201009  
Person to Contact:  
Steve Rudzinski  
Contact Telephone Number:  
1-866-699-4096  
Employee Identification Number:  
22-00001  
Refer Reply to:  
Indoor Tanning Services Tax  
Last Date to Respond to this Letter:  
30 Days from the Date of this Letter

Dear Indoor Tanning Services Provider:

Our records indicate that you may be required to file Form 720, *Quarterly Federal Excise Tax Return*, to report the indoor tanning services excise tax and that you have not done so for the tax period(s) stated above. Generally, a person that receives payment for providing indoor tanning services must collect the tax from the person paying for the services and pay that amount over to the government. A detailed explanation of the tax appears at the end of this letter.

If you are required to file the return, please send your completed, signed return to:

**Department of Treasury  
Internal Revenue Service  
Cincinnati, OH 45999-0009**

If you are not required to file an excise tax return for the indoor tanning services tax, please check the appropriate box that most closely explains why you are not required to file:

- ☐ I provided indoor tanning services during the tax period(s) in question, but all the payments I received were payments to a Qualified Physical Fitness Facility.
- ☐ I am currently out of business and was out of business for the entire tax period(s) to which this letter relates.

Date business ceased: \_\_\_\_\_

If this box is checked, a final Form 720 may be required. See the Form 720 instructions.

**Letter 4664 (3-2011)**  
Catalog Number 57148T



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- ☐ I did not receive payment for indoor tanning services during the entire tax period(s) in question.
- ☐ I provided indoor tanning services but I did not collect the indoor tanning services excise tax **and** I am not liable for the tax.

If this box is checked, please provide a written statement explaining why you are not liable for the tax. See the Explanation of the Indoor Tanning Services Excise Tax.

- ☐ I filed a tax return under another name. List the name and Employer Identification Number (EIN) under which you filed:

Name: \_\_\_\_\_  
EIN: \_\_\_\_\_

- ☐ Other. Please provide a written explanation.

Your written explanation must include your name, address, EIN, Social Security Number if you do not have an EIN, daytime telephone number, and a copy of this letter. Be sure to keep a copy of your submission for your records.

Please send your information to:

**Department of Treasury  
Internal Revenue Service  
Cincinnati, OH 45999-0009  
Stop # 5701G**

Thank you for your cooperation.

Sincerely yours,

Holly L. McCann  
Chief, Excise Tax Program

Enclosures:  
Return Envelope  
Notice 609, *Privacy Act Notice*



## *Affordable Care Act: The Number of Taxpayers Filing Tanning Excise Tax Returns Is Lower Than Expected*

### **Explanation of Indoor Tanning Services Excise Tax**

The Affordable Care Act created Internal Revenue Code section 5000B, which imposes a 10% excise tax on the amount paid for indoor tanning services, including amounts paid by insurance. The tax is paid by the person paying for the indoor tanning services and is collected by the person receiving payment for the services. The indoor tanning services tax became effective on July 1, 2010.

Indoor tanning services are services using any electronic product that incorporates one or more ultraviolet lamps, intended to induce skin tanning.

Indoor tanning services do not include phototherapy services performed by, and on the premises of, a licensed medical professional (such as a dermatologist, psychologist, or registered nurse). Other special rules apply to this tax; see the Instructions to Form 720 and the IRS website [www.irs.gov](http://www.irs.gov).

The tax also does not apply to a membership fee paid to a "Qualified Physical Fitness Facility" (QPFF) that includes access to indoor tanning services. A QPFF means 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 providing indoor tanning services is not a substantial part of the facility's business or activity; and
- That does not sell indoor tanning services for a fee to the general public or otherwise offer different pricing options to its members based in whole or in part on access to indoor tanning services.

#### **The following provides basic information about paying and collecting the indoor tanning services tax:**

An indoor tanning services provider who receives payment for the indoor tanning service must collect the tax at the time a tanning service is purchased (a special rule applies in the case of the sale of a gift certificate, gift card, or other similar item redeemable for indoor tanning services).

- If the indoor tanning services provider does not collect the tax when the payment for the services is received, then the indoor tanning services provider is liable for the tax.
- Within a month after the end of each calendar quarter, the person receiving the payment for the indoor tanning services must report on and pay over to the IRS the full tax with a timely filed Form 720.
- Forms 720 are required to be filed quarterly by April 30, July 31, October 31 and January 31, beginning with the quarter ending September 30, 2010. For example, payments made for indoor tanning services in July, August, and September are reported on the Form 720 that is due by October 31.
- Some providers of indoor tanning services may operate more than one location at which the services are provided. Each business unit that has, or is required to have, a separate Employer Identification Number is treated as a separate person that must file a separate Form 720.

If you need additional information, please go to [www.irs.gov](http://www.irs.gov), click on Affordable Care Act Tax Provisions and scroll down to Excise Tax on Indoor Tanning Services, or you can call 1-866-699-4096 for more information about the indoor tanning services tax.





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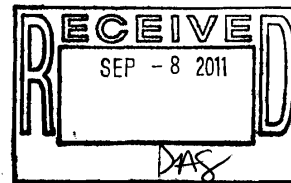
**Appendix V**

*Management's Response to the Draft Report*



COMMISSIONER  
SMALL BUSINESS/SELF-EMPLOYED DIVISION

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224



SEP 07 2011

MEMORANDUM FOR MICHAEL R. PHILLIPS  
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Faris R. Fink *Faris R. Fink*  
Commissioner, Small Business/Self-Employed Division

SUBJECT: Draft Audit Report – Affordable Care Act: The Number of  
Taxpayers Filing Tanning Excise Tax Returns is Lower Than  
Expected (Audit No. 201140001)

Thank you for the opportunity to review your draft report. We appreciate your acknowledgement of the efforts we have already made to timely implement this provision. These include developing a comprehensive implementation plan; revising forms and instructions; and delivering education and outreach. We also developed a risk-based compliance strategy and trained IRS personnel. As a result, we were prepared for the initial filing year challenges associated with the new excise tax on indoor tanning services.

As your report indicates, this is a brand new provision and there is no existing authoritative list of businesses that are required to pay this tax. Instead, the IRS gathered a number of data sources to estimate the total population of affected businesses, including state licensing bureau data and commercial business lists. We have compared the list of taxpayers who have already filed returns with the broader list that we have collected, and have sent explanatory notices to businesses who have not yet filed. Once this analysis is complete, we will have a better sense of how many of the businesses who have not yet filed are actually subject to this new excise tax.

If you have any questions, please contact me, or a member of your staff may contact John H. Imhoff, Director, Specialty Programs, Small Business/Self-Employed Division at (215) 861-1176.

Attachment





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*Affordable Care Act: The Number of Taxpayers  
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Attachment

**RECOMMENDATION 1:**

The Director, SB/SE Specialty Programs should perform further analyses of the data sources used, including the records with incomplete address information, and determine whether a large portion of tanning businesses was not identified.

**CORRECTIVE ACTION:**

We concur with this recommendation and perform the analysis suggested.

**IMPLEMENTATION DATE:**

January 15, 2012

**RESPONSIBLE OFFICIAL(S):**

Director, Specialty Programs, Small Business/Self-Employed Division (SB/SE)

**CORRECTIVE ACTION MONITORING PLAN:**

We will monitor this action as part of our internal management control process.

**RECOMMENDATION 2:**

The Director, SB/SE Specialty Programs should monitor the results from the notices sent to taxpayers that could potentially owe the tanning tax and, if results warrant, consider obtaining additional data sources for compliance use.

**CORRECTIVE ACTION:**

This was the intent of the notice program that the IRS developed. The IRS will consider additional actions according to the results.

**IMPLEMENTATION DATE:**

June 15, 2012

**RESPONSIBLE OFFICIAL(S):**

Director, Specialty Programs, Small Business/Self-Employed Division (SB/SE)

**CORRECTIVE ACTION MONITORING PLAN:**

We will monitor this action as part of our internal management control process.



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*Affordable Care Act: The Number of Taxpayers  
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**RECOMMENDATION 3:**

The Commissioner, Wage and Investment Division, should ensure that the Publication 510 is updated to include information related to the excise tax on indoor tanning services.

**CORRECTIVE ACTION:**

We concur with this recommendation and have already revised Publication 510, Excise Taxes, to include information concerning the Indoor Tanning Tax as of July 15, 2011.

**IMPLEMENTATION DATE:**

Completed/Implemented July 15, 2011

**RESPONSIBLE OFFICIAL(S):**

Director, Media and Publications, Wage and Investment Division

**CORRECTIVE ACTION MONITORING PLAN:**

N/A