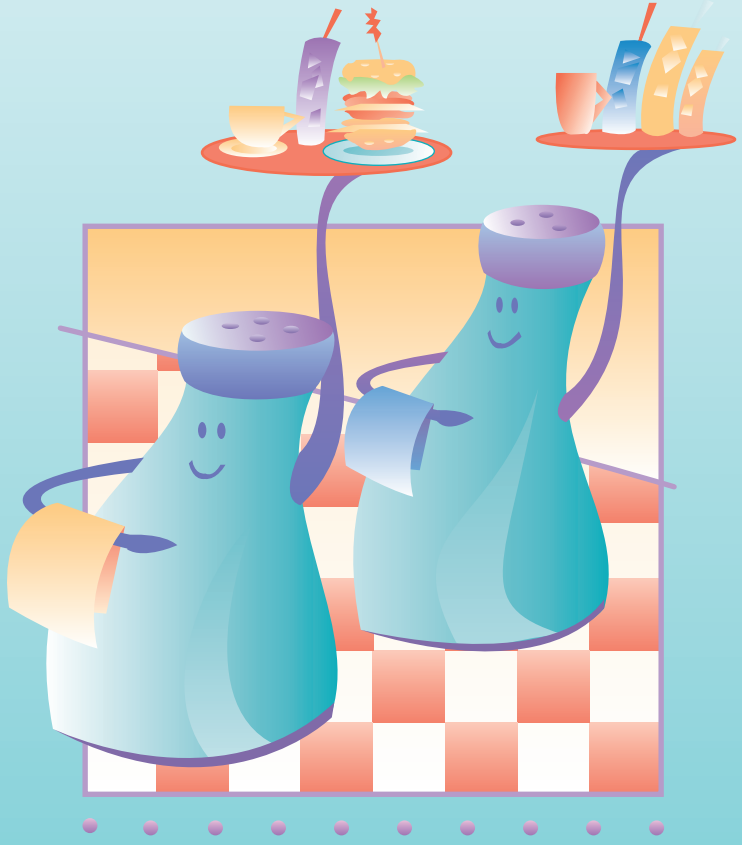
Tips on Tips



A Guide to Tip Income Reporting

for Employees in the Food and Beverage Industry

What tips do I have to report?

Do I have to report *all* my tips to my boss?

If you received $20.00 or more in tips in any one month, you should report *all* your tips to your employer so that federal income tax, social security and Medicare taxes, and maybe state income tax can be withheld.

Do I have to report *all* my tips on my tax return?

Yes. *All* tips are income and should be reported on your tax return.

I was told that I had to report only eight percent (8%) of my total sales as tips. Is this true?

No. You must report to your employer *all* (100%) tips you receive, except for the tips from any month that do not total at least $20.00. The 8% allocation rule is a requirement placed on the employer.

Here's how the 8% rule works:

The employer has to determine if the employees have reported tips in the aggregate of at least 8% of the establishment's gross sales subject to tipping. To put it another way, the employer adds all the establishment's gross receipts (sales where tipping is involved). Then the employer figures 8% of that number. If all the employees' reported-tips total less than that 8% figure, the employer figures out the difference between what the employees reported and the 8% amount. The employer then allocates that difference among all tipped employees. If an employee reported less than the allocated amount to the employer, that allocated amount will appear on the individual's Form W-2, *Wage and Tax Statement*, in the box titled *Allocated Tips*.

Sometimes I don't get tips directly from customers, but rather from another employee. Do I need to report those tips?

Yes. Employees who receive tips from another employee are required to report "tip-outs." Employees often disburse tips out of their earned tips to another employee (tip-outs). Remember, *all* tips are taxable income.

Do I have to report tip-outs that I pay to other employees?

No. You report to your employer only the amount of tips you retain. However, you must maintain records of tip-outs with your other tip income (cash tips, charged tips, split tips, tip pool).

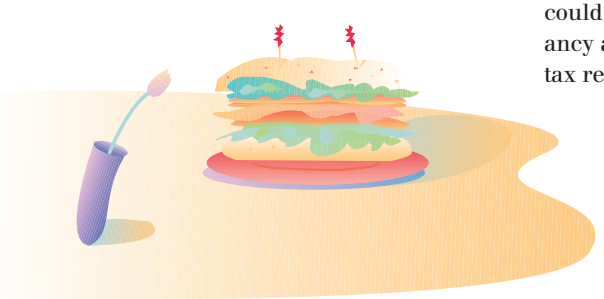
What records do I need to keep?

What type of records do I have to keep?

You must keep a running daily log of all your tip income. You can use Publication 1244, *Employee's Daily Record of Tips and Report to Employer*, to record your tip income for one year. Publication 1244 includes Form 4070, *Employee's Report of Tips to Employer*, and Form 4070A, *Employee's Daily Record of Tips*. These forms have spacing for you to log your name, the employer's name and address, date tips were received, date of entry, tips received, tips paid out, and name of employee paid. For a free copy of Publication 1244, call the IRS at 1-800-829-3676. Your daily log would be your best proof should your income tax return be questioned.

What can happen if I do not keep a record of my tips?

If it is determined in an examination that you underreported your tip income, the IRS will assess the taxes you owe based on the best available records of your employer. Tip income adds up. Underreporting could result in your owing substantial taxes, penalties, and interest.



If I report all my tips to my employer, do I still have to keep records?

Yes. You should keep a daily log of your tips so that in case of an examination, you can substantiate the actual amount of tips received. There are a number of reasons why you might need records:

■ Your return could be randomly selected for a federal income tax examination.

For example: Your Form 1040, *U.S. Individual Income Tax Return*, establishes that you have your own home, two cars, and three exemptions, and your Form W-2 shows that you earned only $10,000 in income. In this scenario, an examination may occur if the examiner determines that income may have been underreported.

■ A tip examiner could review your employer's books and records. The examination could reveal unreported tip income that you may later need to verify.

■ An Internal Revenue Service Center may run a match of your income information from your Form 1040, *U.S. Individual Income Tax Return*, with the income information from your Form W-2. If these figures do not match, you could receive a notice about the discrepancy and a possible examination of your tax return.

How does this affect my income tax filing?

I forgot to report my tip income to my employer, but I remembered to report it on my federal income tax return. Will that present a problem?

If you do not report your tip income to your employer, but you do report the tip income on your federal income tax return, you may owe a 50% social security and Medicare tax penalty and be subject to a negligence penalty and possibly an estimated tax penalty. When you don't report your tips to your employer, it places your employer at risk of possible assessment of the employer's share of social security and Medicare taxes.

If I report all my tips but my taxes on the tips are greater than my pay from my employer, how do I pay the remaining taxes?

You can either pay the tax when you file your federal income tax return or you can reach into your tip money and give some to your employer to be applied to those under-withheld taxes. The employer will then record these taxes and you will get credit on your Form W-2. If you wait to pay when you file your tax return, you may be subject to an estimated tax penalty.

What can happen if I don't report my tips to the IRS?

If the IRS determines through an examination that you underreported your tips, you could be subject to additional federal income tax, social security and Medicare taxes, and maybe state income tax. Also, a penalty of 50% of the additional social security and Medicare taxes, and a negligence penalty of 20% of the additional income tax, plus interest, may apply.

What's in it for me if I report all my tip income?

There are many good reasons why you want to report *all* your tip income:

- Increased income may improve financing approval when applying for mortgage, car, and other loans
- Increased worker's compensation benefits, should you get hurt on the job
- Increased unemployment compensation benefits
- Increased social security and Medicare benefits (the more you pay, the greater your benefits)
- Increased employee pension, annuity, or 401(k) participation
- Check with your employer for other increased benefits (based on pay) your company may offer, such as life insurance, disability, and the right to purchase stock options.
- Compliance with the tax law

What is this compliance program I've heard about?

My employer has entered into a compliance agreement with the IRS concerning tips. What is this?

The national *Tip Rate Determination/ Education Program* was developed in 1993 to help those employees receiving tip income and their employers understand the laws on reporting tip income. Under this program, the employer can enter into one of two arrangements – the *Tip Rate Determination Agreement (TRDA)* or the *Tip Reporting Alternative Commitment (TRAC)* (created in June 1995). You can ask your employer for more information about this program.

TRDA

What is my responsibility, as an employee, under the Tip Rate Determination Agreement?

You are required to file your federal tax returns. You must sign a *Tipped Employee Participation Agreement* proclaiming that you are participating in the program. The employer, as a participant in the *TRDA*, has agreed with the IRS to a tip rate for the employer's establishment. To stay a participating employee, you must report tips at or above the tip rate determined by the agreement. Further, as part of the *TRDA* arrangement, the employer is required to report your name, social security number, the hours worked or sales made, your job classification, and your reported tips to the IRS if you *do not* report tips at or above the determined tip rate.

TRAC

What is my responsibility, as an employee, under the *Tip Reporting Alternative Commitment*?

Directly-tipped employee:

■ Your employer will furnish you a written statement (at least monthly) reflecting your charged tips.

■ You are to verify or correct this statement.

■ You are to indicate the amount of cash tips received.

■ When reporting your cash tips, you should remember that there is a correlation between charged tips and cash tips.

(Your employer may be able to inform you of the establishment's charged sales to cash sales ratio. For example, if the establishment is 50% charge and 50% cash, and you received and reported $100 in tips on charged receipts, it is reasonable to believe that you should be reporting close to $100 in cash tips.)

■ You may be asked to provide the name and amount of any tip-outs to indirectly-tipped employees.

Indirectly-tipped employee:

■ You are required to report all your tips to your employer. If the establishment has the directly-tipped employee provide the name and amount of tips shared with you, the establishment could provide you with a statement of tips that you would need to verify or correct.

Is tip reporting unique to the food & beverage industry?

Does tip income reporting apply only to employees in the food and beverage industry?

No. Anyone who receives tip income is required by law to report it to his or her employer. The *Tip Rate Determination/ Education Program (TRD/EP)* was first promoted in the gaming industry (casino industry) in Las Vegas, Nevada, and subsequently spread to the food and beverage industry. Other individuals that receive tip income include airport skycaps, bartenders, hair stylists, bellhops, casino workers, delivery service people, hotel housekeepers, manicurists, masseuses, parking attendants, railroad redcaps, and taxi drivers.

Why should I report my tips to my employer?

When you report your tip income to your employer, the employer is required to withhold federal income taxes, social security and Medicare taxes, and maybe state income tax. Tip reporting may increase your social security credits resulting in greater social security and Medicare benefits when you retire. Tip reporting may also increase other benefits to which you may become entitled, such as unemployment benefits, worker's compensation, or retirement benefits. Additionally, a greater income may improve financing approval for mortgage, car, and other loans.

Why has tip reporting become such an issue?

To report *all* tip income has always been the law. The IRS has put greater emphasis on reporting tip income over the past few years because a significant number of taxpayers are not reporting *all* tip earnings as income.

How can I get more information?

The IRS provides the following publications and forms relating to tip income reporting. These materials can be downloaded from the IRS Web site at www.irs.ustreas.gov and ordered through the IRS by dialing 1-800-829-3676. (For TTY/TDD equipment access, dial 1-800-829-4059.)

Pub 505 – *Tax Withholding and Estimated Tax*

Pub 531 – *Reporting Tip Income*

Pub 1244 – *Employee's Daily Record of Tips and Report to Employers.* This publication includes **Form 4070**, *Employee's Report of Tips to Employer*, and **Form 4070A**, *Employee's Daily Record of Tips.*

Form 1040ES – *Estimated Tax for Individuals*

Form 4137 – *Social Security and Medicare Tax on Unreported Tip Income*

IRS

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