

[4830-01-u]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 31

[REG-104691-97]

RIN 1545-AV28

Electronic Tip Reports

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document proposes to amend the regulations dealing with the requirement that tipped employees report their tips to their employer. The proposed regulations permit employers to establish electronic systems for use by their tipped employees in reporting tips to the employer. The proposed regulations also address substantiation requirements for employees using the electronic system.

DATES: Written comments and requests for a public hearing must be received by April 27, 1998.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG-104691-97), room 5228, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044.

Submissions may be hand delivered between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG-104691-97), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting

comments directly to the IRS Internet site at
http://www.irs.ustreas.gov/prod/tax_regs/comments.html.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Karin Loverud, 202-622-6060; concerning submissions, Evangelista Lee, 202-622-8452 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in this notice of proposed rulemaking has been submitted to the **Office of Management and Budget** for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)).

Comments on the collection of information should be sent to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, T:FP, Washington, DC 20224. Comments on the collection of information should be received by March 27, 1998. Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper performance of the functions of the **Internal Revenue Service**, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information (see below);

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collection of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of service to provide information.

The collections of information in this proposed regulation are in §31.6053-1 and §31.6053-4. This information is required to conform with the statute and to assist employers and employees in fulfilling their responsibilities. This information will be used by employers to establish the amount of income and FICA (or RRTA) taxes to withhold from the employee reporting the tips. This information will be used by employees in meeting the substantiation requirements. The collections of information are mandatory. The likely respondents are individuals.

Estimated total annual reporting burden: 600,000 hours.

Estimated average annual burden hours per respondent: 2 hours.

Estimated number of respondents: 300,000.

Estimated annual frequency of responses: varies.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

This document contains proposed amendments to the Employment Tax Regulations (26 CFR part 31) under section 6053(a) of the Internal Revenue Code (Code). The proposed regulations provide rules permitting employers to establish electronic systems for use by their tipped employees in reporting tips to the employer.

In general, under section 6053(a) of the Code, every employee who receives tips must report the tips to the employer. The tips that must be reported are those that are wages for purposes of federal income tax withholding and the Federal Insurance Contributions Act (FICA) and compensation for purposes of the Railroad Retirement Tax Act (RRTA). The tips must be reported in a written statement or statements furnished to the employer on or before the 10th day

following the month in which the tips are received. The Secretary is authorized to prescribe rules necessary to implement this provision, including the form and manner of furnishing the statements.

Generally, all cash tips (which include tips that are charged) are wages (or compensation), with one exception. If the amount of cash tips received in a calendar month by an employee in the course of any one employment is less than \$20, the cash tips received in that employment during that month are not wages subject to income tax withholding, FICA taxes, or RRTA taxes.

For example, A is a full-time tipped employee of X and a part-time tipped employee of Y. During the month, A received \$1,000 in tips in A's employment with X and \$10 in tips in A's employment with Y. The \$1,000 in tips received in the course of employment with X are wages for income tax withholding and FICA (or RRTA) tax purposes. A must report the \$1,000 in tips to X no later than the 10th day of the following month. The \$10 in tips received in the course of employment with Y are not wages for those purposes. The \$10 are, however, subject to federal income tax and must be reported as wages by the employee on Form 4137, Social Security and Medicare Tax on Unreported Tip Income, which the employee must file with Form 1040, U.S. Individual Income Tax Return.

Section 31.6053-1(b)(1) prescribes rules for tip statements. The statement furnished by the employee to the employer must be in writing and must be signed by the employee. The statement must disclose (1) the employee's name, address, and social security number; (2) the employer's name and address; (3) the period for which and the date on which the statement is furnished; and (4) the total amount of tips received by the employee during the period that are required to be reported to the employer.

Under §31.6053-1(b)(2), no particular form is prescribed for use in furnishing the tip statement. If the employer does not provide a form for use by the employee in reporting tips received by the employee, the employee may use Form 4070, Employee's Report of Tips to Employer.

Twelve blank Forms 4070 and 12 blank Forms 4070A, Employee's Daily Record of Tips are reproduced in Publication 1244, Employee's Daily Record of Tips and Report to Employer.

(Daily completion of Form 4070A constitutes sufficient evidence of tip income under the substantiation requirements of §31.6053-4.) Pub. 1244 is a convenient pocket-sized document that also includes the basic rules for reporting tips. Copies of Pub. 1244 are available from the IRS by calling 1-800-829-3676.

The regulations specifically permit employers to design their own forms for use by employees in reporting tips. A form used solely to report tips must include (1) the

employee's name, address, and social security number; (2) the employer's name and address; (3) the period for which and the date on which the statement is furnished; and (4) the total amount of tips received by the employee during the period that are required to be reported to the employer.

In lieu of a special tip reporting form that is used solely for the purpose of reporting tips, employers may provide for reporting of tips on regularly used forms, such as time cards. The regularly used forms need not include the employer information, but they must accurately identify the employee, identify the reporting period, and specify the amount of tips received. If a regularly used form is used to report tips, the employer must furnish the employee a statement showing the amount of tips reported by the employee for the period. This statement must be furnished no later than shortly after the first wage payment following the employee's tip report. A payroll check stub or other similar payroll document may be used for this purpose.

The period covered by a tip statement may not exceed one calendar month. An employer may require tip statements more frequently, such daily, weekly or every pay period, if not less frequently than monthly. In no event, however, may an employer permit tips received in one month to be reported after the 10th of the following month. See section 6053(a). For example, X has a weekly payroll period, beginning on Sunday and ending on Saturday. X requires that all tip

statements be submitted to X no later than the Monday following each payroll period. For the payroll period beginning on Sunday, March 30, and ending on Saturday, April 5, the statements must be furnished on or before Monday, April 7. If this occurs, the 10th-of-the-month requirement for March is met. If X's payroll period were biweekly and began on March 30 and ended on April 16 and if X required that all tip statements be submitted to X no later than the Monday following each payroll period, the 10th-of-the-month requirement for March would not be met.

A tip statement furnished after this deadline does not meet the requirements of section 6053(a). The employer is not required to withhold income, FICA, or RRTA taxes on tips reported after the 10th of the following month and is not responsible for reporting those tips to the IRS. The responsibility for reporting and paying the employee portion of the FICA tax shifts to the employee. The employee must complete and attach Form 4137, Social Security and Medicare Tax on Unreported Tip Income, to the employee's federal income tax return. Moreover, an employee who fails to report tips as required by section 6053(a) is subject to an addition to the FICA tax or the RRTA tax, whichever is applicable, equal to 50 percent of the employee portion of the FICA or RRTA tax on those tips.

Section 31.6053-4(a)(1) provides that an employee must maintain sufficient evidence to establish the amount of tip

income received during a taxable year. Sufficient evidence consists of either a daily record or, if the employee does not maintain a daily record, other evidence (such as documentary evidence) that is as credible and as reliable as a daily record. Nevertheless, if the facts or circumstances indicate that the employee received a larger amount of tip income, a daily record or other evidence may not be sufficient evidence.

Section 31.6053-4(a)(2) describes the requirements for a daily record. In general, the daily record must show the amount of cash and charge tips received directly from customers or other employees and the amount of tips, if any, that the employee paid out to other employees through tip sharing, tip pooling, or other arrangements and the names of the employees. The daily record must show the date on which each entry is made. Each entry must be made on or near the date the tip income is received. An entry made when the employee has full present knowledge of those receipts and payments satisfies this requirement.

Section 31.6053-4(a)(3) describes documentary evidence. Documentary evidence consists of copies of any documents that contain amounts added as a tip to a check by a customer or amounts paid by a customer for food or beverages with respect to which tips generally would be received. Examples of documentary evidence are copies of restaurant bills,

credit card charges, or charges under any other arrangement containing amounts added by the customer as a tip.

Explanation of Provisions

Electronic tip statements. No provision currently exists for employees to furnish tip statements to employers in a form other than on paper. The proposed regulations would permit an employer to adopt a system under which some or all of the tipped employees of the employer would furnish their tip statements electronically. Therefore, the employer could include in its electronic system any tipped employee or employees working in any location or locations.

The proposed regulations set forth requirements for employers who wish to establish electronic systems for employees to use to furnish tip statements to their employers. The proposed regulations apply only to tip statements required by section 6053(a) and not with respect to any other Code sections.

An employer that chooses to establish an electronic tip reporting system may select the type or types of electronic systems (such as telephone or computer) to be used by its employees. The system must, however, ensure that the information received is the information transmitted by the employee and must document all occasions of access that result in the transmission of a tip statement. The design and operation of the electronic system, including access procedures, must make it reasonably certain that the person

accessing the system and transmitting the tip statement is the employee identified in the transmission. In the event of an examination, the employer must supply a hard copy of the electronic statement to the IRS upon request.

The electronic tip statement must contain exactly the same information that is required to be reported on a paper tip statement and must contain the employee's electronic signature. The electronic signature must identify the employee furnishing the electronic tip statement and authenticate and verify the transmission. An electronic signature can be in any form that satisfies the foregoing requirements. An electronic signature has the same effect as a signature written on a paper tip statement. See sections 6061, 6064, and 6065 of the Code.

Pursuant to Rev. Rul. 71-20 (1971-1 C.B. 392), all machine-sensible data media used for recording, consolidating, and summarizing accounting transactions and records within a taxpayer's ADP system are records within the meaning of section 6001 and §1.6001-1. The record retention requirements contained in Rev. Proc. 91-59 (1991-2 C.B. 841) (or any revenue procedure updating Rev. Proc. 91-59), dealing with automatic data processing systems, apply to electronic tip reporting systems.

The proposed regulations provide that an employee maintains sufficient evidence to establish the amount of tip income received by the employee during a calendar month

through a daily record (as described in §31.6053-4(a)(2)) if the employee both reports tips on a daily basis through an electronic system that otherwise meets the substantiation requirements of the regulations and receives from the employer a hard copy of a daily record based on those entries for the period.

Employee substantiation requirements. Because the proposed regulations expand the permissible array of employer-designed reporting systems to include electronic methods, employers will be providing a statement to employees of the tips reported consistent with the existing requirements of §31.6053-1(b). The Treasury and the IRS recognize that many of these systems may capture tip reporting on a very current basis (e.g., point-of-sale or end-of-shift). Thus, the information in these systems offers a reasonable substitute for a daily record maintained by the employee if the employer's system provides the employee with a printout that would satisfy the current substantiation requirements of §31.6053-4.

Thus, these proposed regulations provide that, if the employer, at its option, provides employees with a copy of the daily record based on entries made by the employee in the system and otherwise satisfying the substantiation requirement of §31.6053-4, the entry in the electronic system on a daily (or more frequent) basis by the employee, together with the daily record based on these entries

provided by the employer, will satisfy the substantiation requirements of §31.6053-4. For example, assume an employee enters tips in the employer's electronic system at the end of each shift, but does not provide the employer with a signed paper record of these tips. After the end of each weekly payroll period, the employer provides the employee with a paper record that includes all the information specified in §31.6053-4(a)(2) and that shows the total amount of tips reported for each day during the period based on the employee's entries. If the employee maintains this employer generated paper record, the substantiation requirements of §31.6053-4 are satisfied.

The Treasury and the IRS particularly invite comment on whether the proposed regulations should be modified to reflect ways in which these systems may permit further reduction in paper reporting for either the employer or employee while retaining provisions for appropriate and timely substantiation of income.

Railroad Retirement Tax Act provisions. The tip reporting provisions of section 6053(a) apply to tips that are either wages for income tax withholding and Federal Insurance Contributions Act (FICA) purposes or compensation for Railroad Retirement Tax Act (RRTA) purposes. The proposed regulations would clarify that the regulations under section 6053(a) apply to tips that are compensation as well as to tips that are wages.

Proposed Effective Date

The revisions and additions in the proposed regulations apply to tips required to be reported to the employer after these regulations are published as final regulations in the **Federal Register**. However, taxpayers may rely on the guidance in these proposed regulations for prior periods.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations.

It is hereby certified that the collections of information in these regulations will not have a significant economic impact on a substantial number of small entities. The collection of information in §31.6053-1 is imposed solely on individuals, not on any small entities, and the regulations provide flexibility to employees who must provide the information required by statute, thereby reducing burden. With respect to the collection of information in §31.6053-4, the certification is based on the expectation of the IRS that most businesses that choose to implement the electronic tip reporting provisions will be larger businesses with many employees and sophisticated

computer systems. Moreover, because the provision is wholly elective, any small business that would be adversely impacted may choose not to use electronic tip reporting. Finally, the Service expects that for those small entities that choose to implement the provision, the use of electronic tip reporting will reduce overall burden by reducing paper collections. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required.

Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight copies) that are submitted timely (in the manner described in the ADDRESSES portion of this preamble) to the IRS. All comments will be available for public inspection and copying.

A public hearing may be scheduled if requested in writing by any person that timely submits written comments. The IRS will also consider requests for remote teleconference sites as part of the public hearing. If a public hearing is scheduled, notice of the date, time, and

place (including teleconference, if any) for the hearing will be published in the **Federal Register**.

Drafting Information

The principal author of these proposed regulations is Karin Loverud, Office of the Associate Chief Counsel (Employee Benefits and Exempt Organizations), IRS. However, other personnel from the IRS and the Treasury Department participated in their development.

List of Subjects in 26 CFR Part 31

Employment taxes, Income taxes, Penalties, Pensions, Railroad retirement, Reporting and recordkeeping requirements, Social security, Unemployment compensation.

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 31 is proposed to be amended as follows:

PART 31--EMPLOYMENT TAXES AND COLLECTION OF INCOME TAX AT SOURCE

Paragraph 1. The authority citation for part 31 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 31.6053-1 is amended as follows:

1. Paragraph (a) is revised.
2. The introductory text of paragraph (b)(1) is revised.

3. The last sentence of paragraph (b)(1)(iii) is revised.

4. Paragraph (b)(2) is revised.

5. Paragraph (c) is revised.

6. Paragraph (d) is added.

The revisions and additions read as follows:

§31.6053-1 Report of tips by employee to employer.

(a) Requirement that tips be reported--(1) In general. An employee who receives, in the course of employment by an employer, tips that constitute wages as defined in section 3121(a) or section 3401, or compensation as defined in section 3231(e), must furnish to the employer a statement, or statements, disclosing the total amount of the tips received by the employee in the course of employment by the employer. Tips received by an employee in a calendar month in the course of employment by an employer that are required to be reported to the employer must be reported on or before the 10th day of the following month. Thus, for example, tips received by an employee in January 1998 are required to be reported by the employee to the employer on or before February 10, 1998.

(2) Cross references. For provisions relating to the treatment of tips as wages for purposes of the Federal Insurance Contributions Act (FICA) tax under sections 3101 and 3111, see sections 3102(c), 3121(a)(12), and 3121(q) and §§31.3102-3 and 31.3121(a)(12)-1. For provisions relating

to the treatment of tips as wages for purposes of the tax under section 3402 (income tax withholding), see sections 3401(a)(16), 3401(f), and 3402(k) and §§31.3401(a)(16)-1, 31.3401(f)-1, and 31.3402(k)-1. For provisions relating to the treatment of tips as compensation for purposes of the Railroad Retirement Tax Act (RRTA) tax under sections 3201 and 3221, see section 3231(e) and §31.3231(e)-1(a).

(b) * * * (1) In general. The statement described in paragraph (a) of this section can be provided on paper or transmitted electronically. The statement must be signed by the employee and must disclose:

(iii) * * * If the statement is for a period of less than 1 calendar month, the beginning and ending dates of the period must be included (for example, January 1 through January 8, 1998).

(2) Form of statement--(i) In general. No particular form is prescribed for use in furnishing the statement required by this section. The statement may be furnished on paper or transmitted electronically. An electronic system and all tip statements generated by that system must meet the requirements of paragraph (d) of this section. If the employer does not provide any other means for the employee to report tips, the employee may use Form 4070, Employee's Report of Tips to Employer.

(ii) Single-purpose forms. A statement may be furnished on an employer-provided form. The form may be on paper or in electronic form. An employer that provides a paper form must make blank copies of the form readily available to all tipped employees. Any form, whether paper or electronic, provided by an employer for use by its tipped employees solely to report tips must meet all the requirements of paragraph (b)(1) of this section.

(iii) Regularly used forms. Instead of requiring that tips be reported as described in paragraph (b)(2)(ii) of this section on a special form used solely for tip reporting, an employer may prescribe regularly used forms for use by employees in reporting tips. A regularly used form may be on paper (such as a time card or report) or in electronic form, must meet the requirements of paragraph (b)(1)(iii) and (iv) of this section, must contain identifying information that will ensure accurate identification of the employee by the employer, and is permitted to be used only if the employer furnishes the employee a statement suitable for retention showing the amount of tips reported by the employee for the period. The employer statement may be furnished when the employee reports the tips, when wages are first paid following the reporting of tips by the employee, or within a short time after the wages are paid. The employer may meet this requirement, for example, through the use of a payroll check

stub or other payroll document regularly furnished by the employer to the employee showing gross pay and deductions. In the case of electronic tip reports, the employer statement may be furnished on a daily, weekly, monthly or on a regular payroll basis (if not less frequent than monthly).

(c) Period covered by, and due date of, tip statement--(1) In general. A tip statement furnished by an employee to an employer may not cover a period greater than 1 calendar month. An employer may, however, require the submission of a statement in respect of a specified period of time, for example, on a weekly or biweekly basis, regular payroll period, etc. An employer may specify, subject to the limitation in paragraph (a) of this section, the time within which, or the date on which, the statement for a specified period of time should be submitted by the employee. For example, a statement covering a payroll period may be required to be submitted on the first (or second) day following the close of the payroll period. A statement submitted by an employee after the date specified by the employer for its submission nevertheless will be considered as a statement furnished pursuant to section 6053(a) and this section if it is submitted to the employer on or before the 10th day following the month in which the tips were received.

(2) Termination of employment. If an employee's employment is terminating, the employee must furnish a tip

statement to the employer when the employee ceases to perform services for the employer. A statement submitted by an employee after the date on which the employee ceases to perform services for the employer will be considered as a statement furnished pursuant to section 6053(a) and this section if the statement is submitted to the employer on or before the earlier of the day on which the final wage payment is made by the employer to the employee or the 10th day following the month in which the tips were received.

(d) Requirements for electronic systems--(1) In general. The electronic system must ensure that the information received is the information transmitted by the employee and must document all occasions of access that result in the transmission of a tip statement. In addition, the design and operation of the electronic system, including access procedures, must make it reasonably certain that the person accessing the system and transmitting the statement is the employee identified in the statement transmitted.

(2) Same information as on paper statement. The electronic tip statement must provide the employer with all the information required by paragraph (b)(1) of this section.

(3) Signature. The electronic tip statement must be signed by the employee. The electronic signature must identify the employee transmitting the electronic tip statement and must authenticate and verify the transmission.

For this purpose, the terms "authenticate" and "verify" have the same meanings as they do when applied to a written signature on a paper tip statement. An electronic signature can be in any form that satisfies the foregoing requirements.

(4) Copies of electronic tip statements. Upon request by the Internal Revenue Service (IRS), the employer must supply the IRS with a hard copy of the electronic tip statement and a statement that, to the best of the employer's knowledge, the electronic tip statement was filed by the named employee. The hard copy of the electronic tip statement must provide the information required by paragraph (b)(1) of this section, but need not be a facsimile of Form 4070 or any employer-designed form.

(5) Record retention. The record retention requirements dealing with automatic data processing systems apply to electronic tip reporting systems.

Par. 3. Section 31.6053-4 is amended as follows:

1. A sentence is added to paragraph (a)(1) after the third sentence.

2. A sentence is added to paragraph (a)(2) after the fourth sentence.

The additions read as follows:

§31.6053-4 Substantiation requirements for tipped employees.

(a) * * *

(1) * * * The Commissioner may by revenue ruling, procedure or other guidance of general applicability provide for other methods of demonstrating evidence of tip income. * * *

(2) * * * In addition, an electronic system maintained by the employer that collects substantially similar information as Form 4070A may be used to maintain such daily record, provided the employee receives and maintains a paper copy of the daily record. * * *

Deputy Commissioner of Internal Revenue