

Tips on Tips

A Guide to Tip Income Reporting

for Employees
Who Receive Tip Income

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**If you work at a hair salon,
barber shop, casino, golf course,
airport, hotel, or perform cleaning,
food delivery, or taxi cab services,
and receive tips, this
guide is for you.**

The tip income you receive as an employee from the services such as those listed above – whether cash or included in a charge – is taxable income. As taxable income, these tips are subject to federal income tax, social security and Medicare taxes, and may be subject to state income tax as well.

The Internal Revenue Service (IRS) has prepared this guide to aid the employee who may need answers to tip income reporting questions.

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 taxable income and should be reported on your tax return.



I was told that I had to report only a certain percentage 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.

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. Your daily log would be your best proof should your income tax return be questioned. For a free copy of Publication 1244, call the IRS at 1-800-829-3676.



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 you 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 record 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 record 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 do not 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 larger loan amounts (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) that your company may offer, such as life insurance, disability payments, and the right to purchase stock options
- Compliance with the tax law

Is tip reporting unique to a specific industry?

Does tip income reporting apply only to employees in a specific 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 to the food and beverage industry. Other individuals that receive tip income include airport skycaps, bartenders, hair stylists, bellhops, casino workers, delivery service people, golf caddies, 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 their tip earnings as taxable income.



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

Currently, the TRDA is only available to the food and beverage industry and the gaming (casino) industry.

At this time, TRAC is open to the food and beverage industry and the hair styling industry. Ask your employer for more information about this arrangement as it may be extended to other industries where tipping is customary.

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

You are required to file your federal tax returns. You may be asked to 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. Furthermore, 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 with 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.



The IRS provides the following publications and forms relating to tip income reporting. These products can be downloaded from the IRS Web site at www.irs.ustreas.gov and ordered through the IRS by dialing 1-800-829-3676. (TTY/TDD equipment access, dial 1-800-829-4059.) You can also get IRS forms with instructions faxed back to you when you dial (703) 368-9694 from a fax machine and follow the voice prompts.

Pub 505 -*Tax Withholding and Estimated Tax*

Pub 531 -*Reporting Tip Income*

Pub 1244-*Employee's Daily Record of Tips and Report to Employer*. 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*

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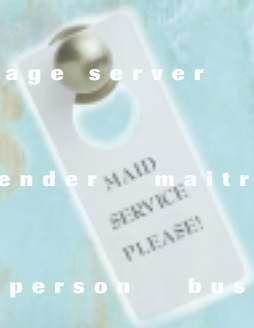
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