

Tips on Tips

A Guide to
Tip Income Reporting
for Employers in Businesses
Where Tip Income is Customary

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If you are an employer of an employee who receives tip income, this guide is for you.

The Internal Revenue Service (IRS) began its Tip Rate Determination/Education Program (TRD/EP) in October 1993 for businesses where tip income is customary. The objective of the Program has been to improve and ensure compliance by employers and employees with statutory provisions relating to tip income.

The Program of Tip Reporting

What tip reporting options are available?

n *Tip Rate Determination Agreement (TRDA)*

n *Tip Reporting Alternative Commitment (TRAC)*

n Institute your own reporting system to comply with the tax law.

Under the Tip Rate Determination/Education Program (TRD/EP), the employer may enter into a TRDA or a TRAC arrangement, depending on the specific business. The IRS will assist applicants in understanding and meeting the requirements for participation. The next pages show how these two arrangements differ.

How does the program benefit my employees?

There are a number of reasons why an employee should report all of his/her tip income:

- n Increased income may improve financial approval when applying for mortgage, car, and other loans
- n Increased social security and Medicare benefits (the more you pay, the greater the benefits)
- n Increased unemployment compensation benefits
- n Increased employee pension, annuity, or 401(k) participation (if applicable)
- n Increased workers' compensation benefits, should your employees get hurt on the job



How To Get Your Program Underway

How To Apply

To enter into one of the arrangements, submit an application letter to your area IRS TEC Territory Manager, Tip Program Coordinator. The Tip Coordinator can provide a letter format as well as extensive information on the two separate arrangements. Check your telephone directory for the IRS office in your area. They can provide the mailing address of the Tip Coordinator.

Who Should Apply

Currently, the IRS is offering participation in TRD/EP to employers in the food and beverage, hairstyling, and gaming (casino) industries. Plans are underway to extend this program to all industries where tipping is customary.

All employers with establishments where tipping is customary should review their operations. Then, if it is determined that there is or has been an underreporting of tips, the employer may apply for one of the two arrangements (depending on their specific business) under the TRD/EP - TRDA, TRAC.

Note: Employers currently under a TRDA, and wishing to switch to a TRAC, must first terminate their TRDA.

When To Apply

An employer may apply for one of the two arrangements, depending on his/her specific business, at any time. The effective date of the arrangement is determined by receipt and handling of the employer's application.

TRDA is effective as of the date the IRS Territory Manager signs the arrangement.

TRAC is generally effective as of the first day of the quarter following the date the Territory Manager signs the agreement.



TRDA vs. TRAC (how they differ)

TRDA

TRDA requires the IRS to work with the establishment to arrive at a tip rate for the establishment's various occupations.

TRAC

TRAC does not require that a tip rate be established but it does require the employer to:

- n establish a procedure where a directly-tipped employee is provided (no less than monthly) a written statement of charged tips attributed to the employee.
- n implement a procedure for the employees to verify or correct any statement of attributed tips.
- n adopt a method where an indirectly-tipped employee reports his or her tips (no less than monthly). This could include a statement prepared by the employer and verified or corrected by the employee.
- n establish a procedure where a written statement is prepared and processed (no less than monthly) reflecting all cash tips attributable to sales of the directly-tipped employee.

TRDA requires the employee to enter into a *Tipped Employee Participation Agreement (TEPA)* with the employer.

TRAC does not require an agreement between the employee and the employer.

TRDA**TRAC**

TRDA requires the employer to get 75% of the employees to sign *TEPAs* and report at or above the determined rate.

TRAC affects all (100%) employees.

TRDA provides that if employees fail to report at or above the determined rate, the employer will provide the names of those employees, their social security numbers, job classification, sales, hours worked, and amount of tips reported.

TRAC provides that if the employees of an establishment collectively underreport their tip income, tip examinations may occur but only for those employees that underreport.

TRDA has no specific education requirement.

TRAC includes a commitment by the employer to educate and reeducate quarterly all directly and indirectly-tipped employees and new hires of their statutory requirement to report all tips to their employer.

TRDA participation assures the employer that prior periods will not be examined as long as participants comply with the requirements under the agreement.

TRAC includes the same rule.



Example of a TRAC Statement



Use the following “example” to help you develop your statement for your specific business, and provide a copy to your employees. (The following example is designed specifically for employees in the food and beverage industry.) A TRAC statement is given to an employee showing tips attributed to him/her. This example not only fulfills the statement required for charged tips but also for cash tip reporting and for indirectly-tipped employee reporting.

The following is a list of IRS publications and forms relating to tip income reporting that can be downloaded from the IRS Web site at www.irs.ustreas.gov and can be ordered through the IRS by dialing 1-800-829-3676. 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 941 – *Employer’s Quarterly Federal Tax Return*

Form 1040ES – *Estimated Tax for Individuals*

Form 4157 – *Social Security and Medicare Tax on Unreported Tip Income*

Form 8027 – *Employer’s Annual Information of Tip Income and Allocated Tips*

Form W-2– *Wage and Tax Statement; and separate Instructions for Forms W-2 and W-3*

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IRS

Department of the Treasury
Internal Revenue Service

www.irs.gov

Publication 3144 (Rev. 3-2005)
Catalog Number 26288G

