

EMPLOYEE REPORTING REQUIREMENTS

Employees who receive \$20 or more per calendar month in tips must report their tip income to their employer. The report is required to be in writing and be submitted to the employer by the 10th day of the following month. If the 10th day of the month is a Saturday, Sunday or legal holiday, the report may be submitted no later than the next day which is not a Saturday, Sunday or legal holiday. An employer, however, can require employees to report their tips more often than monthly. But as long as a written report is submitted by the tenth of the month by each employee whose monthly tips exceeded \$20, the law's requirements have been met.

The report can be IRS Form 4070, an alternate form furnished by the employer or any other written statement provided that the following information is included:

- Name, address and social security number of employee;
- Name and address of the employer;
- Calendar month or other period covered by the report; and
- Total amount of tips received by employee during reporting period.

The report should be signed and dated by the employee.

If the employment relationship ends in a month in which the employee has received at least \$20 in tips, the employee must report tip income prior to the day on which the last wage payment is made but no later than the 10th of the following month.

Although it is not required, employees should keep a daily record of some kind as evidence of their tip income. IRS Form 4070-A can be used for this. Both Forms 4070 and 4070-A are included in IRS Publication 1244.

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An employer is required to include tips on Form 941, Employer's Quarterly Tax Return. Regardless of whether or not income taxes or FICA taxes have been withheld, tips reported by employees must be included. Tips are considered paid when reported, therefore tips (totaling \$20 or more) received in March and reported to the employer in April would be included on the second quarter Form 941. Form 940, Employer's Annual Federal Unemployment Tax Return, must also include reported tips.

For bookkeeping purposes, the total tips received for the month or pay period are added to the employee's gross pay before calculating tax withholdings and then, subtracted from net pay.

**ADDITIONAL REQUIREMENTS FOR
LARGE FOOD AND/OR BEVERAGE ESTABLISHMENTS**

Food and/or beverage establishments that meet the criteria for being "large" are subject to additional reporting to the IRS concerning receipts from food and beverage operations and their employees' tip income. Establishments where tipping is not customary, such as fast food restaurants, and establishments that add a service charge of at least 10 percent to 95 percent of sales are not subject to the additional IRS reporting, even if they are considered "large." Large food and beverage operations have employed more than ten people on a typical business day during the preceding calendar year. An employer is considered to have more than ten employees on a typical business day if the average number of hours worked by all employees in food and beverage operations is more than 80. In computing the average, the employer selects the two months from the preceding year with the highest and lowest gross receipts (a month in which the establishment was not open for business cannot be considered a month with the lowest gross receipts). Also, when computing the hours worked by all employees, any hours worked by an individual who owns at least half of the stock of the business must be excluded. If a business was in operation for less one calendar month in the preceding year, it will have met the more than ten employees criterion if during two consecutive months in the current year, the average number of hours worked per business day by all employees was more than 80.

Subject establishments have to comply with special tip allocation rules if their tipped employees report a low level of tip income. Specifically, if employees of a subject establishment report tips that total less than 8 percent of total sales during an allocation period, additional tip income must be allocated to tipped employees. In definition, total sales do not include carryout sales, state or local taxes, or sales on which there was a service charge of 10 percent or more, and an allocation period can be a payroll period, the calendar year or any other reasonable unit of measurement, such as a month.

The employer calculates 8 percent of sales and compares that figure to the total tips reported during the same time period. If the tip amount is less than the 8 percent of sales, then the difference must be allocated as

tip income to those employees who receive tips directly from customers. None should be allocated, however, to any employee whose reported tips are more than or equal to his or her prorated share of 8 percent of sales. Tips may be allocated according to any formula agreed to by both the employer and employees. The agreement must be in writing and have the consent of at least two-thirds of each category of tipped employees (such as waiters and waitresses, bartenders, etc...) employed at the time and must be revocable if in writing and approved by two-thirds of the employees in the affected categories. If agreement on a formula for allocation cannot be reached, the IRS will provide one.

An employer subject to the reporting requirements under the tip allocation rules must submit IRS Form 8027, Employer's Annual Information return of Tip Income and Allocated Tips. This form must be filed by the end of February following the year being reported. A separate report for each food and beverage operation must include the following information:

- The employer's name, address and employer identification number.
- The establishment's name, address and establishment number.
- Total gross receipts from food and beverage sales (as was defined earlier).
- Total amount of charge receipts on which customers showed tips.
- Total amount of tips reported by employees.
- Total amount of service charges of less than 10 percent collected from customers and paid to employees as wages.

- Name and social security number of each employee to whom tips were allocated and the amount allocated to each one.

An employer must report allocated tip income on Form W-2 separate from wages and reported tips. The employer does not, however, withhold taxes on these amounts. Allocated tips are not reportable on Form 941, as they are not subject to FICA or federal income tax withholding.

TIPS AND THE MINIMUM WAGE

A tipped employee is defined as an employee who "customarily and regularly" receives more than \$30 per month in tips. It should be noted that a tip is an arbitrary amount voluntarily given by a customer for services. A service charge, such as an automatic 15% that is added to the bill of a large party, is not a tip and cannot enter into the calculation of the tip credit. Waiters, bartenders and busboys typically meet the criteria for tipped employees. Failure to receive \$30 in tips one month for reasons such as sickness, vacation or seasonal fluctuations does not cause tipped employees to lose their status.

If an employee is a "tipped employee," the employer may credit any tips received by the worker to cover up to \$3.02 of that worker's hourly wage. Under a provision of the Small Business Protection Act, employers are required to pay tipped employees a minimum of \$5.15 an hour, effective Sept. 1, 1997, of which up to \$3.02 may be paid in tips. In order to be eligible for the tip credit, an employer must notify employees of the statutory tip credit provision and permit employees to keep all their tips. An employer who retains his or her employees' tips is disallowed the tip credit and is responsible for paying the full minimum wage. The following is an example of how the tip credit is applied.

Brian, a waiter, is paid \$2.75 an hour in cash wages, plus tips. During one week, he works 40 hours and earns \$200 in tips, or an average of \$5.00 per hour in tip income. From Brian's tips, the employer may apply a maximum of \$3.02 an hour toward meeting the minimum wage. Brian's hourly rate ($\$2.75 + \$3.02 = \$5.77$) meets the FLSA minimum.

However, the following week, because of street repairs in front of the restaurant, Brian earns only \$75 in tips for 40 hours, or an average of \$1.88 an hour. That, combined with his hourly wage of \$2.75, comes to only \$4.63 an hour. The employer must pay Brian an additional 52 cents an hour, or \$20.80 for the week, to satisfy the minimum wage obligation.

Two important issues employers need to be aware of regarding the tip credit are that they are prohibited from using a different tip credit during overtime hours than they use during straight-time hours, and that the amount of tip credit may not exceed the amount of tips actually received by the employee.