

## **GETTING STIFFED BY EMPLOYEE TIPS:**

When employees fail to report their tips, your business pays.

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Two years ago you opened the newest local sports pub in town, offering the city's longest list of beers on tap. Just last month your establishment made the spring "Top 10 List" in your city's local restaurant and bar magazine. Now the line of patrons waiting outside every night rivals the brew list indoors. Just as you finish interviewing a new bartender to meet the increased demand, you open a letter from the Internal Revenue Service ("IRS") informing you that your business is under a tip examination.

If you own a pub, restaurant, or any other establishment that employs individuals who receive tips, then your business could be targeted for an IRS tip examination.

### **Your employees must report the cash tips they receive**

Employees generally must report their "cash tips" to their employer in a written statement. 26 U.S.C. ("I.R.C.") § 6053(a). "Cash tips" include amounts received in the form of cash directly from customers, amounts distributed by an employer (e.g., credit card charged tips), and amounts received from other employees under a tip-sharing arrangement. There is a *de minimis* exception, however, when an employee receives less than \$20 in tips in a calendar month. Employees who fail to report their cash tips to their employer may be subject to a penalty. I.R.C. § 6652.

### **Your business could be deemed a "Large Food or Beverage Establishment"**

Special rules apply to "large food or beverage establishments" ("LFBE"). Your establishment may be deemed an LFBE if tipping is customary, food or beverages are provided for consumption on the premises, and you normally employ more than 10 employees on a typical business day. 26 C.F.R. § 31.6053-3(j)(7). Generally, if your business is classified as an LFBE and the total cash tips reported by all employees are less than 8% of your gross receipts, then you must allocate the difference among your directly tipped employees to bring the total cash tips up to at least 8% of those receipts. 26 C.F.R. § 31.6053-3(f). Also, if classified as an LFBE, your business must file a Form 8027, Employer's Annual Information Return of Tip Income and Allocated Tips, to make annual reports to the IRS on your food or beverage receipts and your employees' tips. I.R.C. § 6053(c).

### **IRS tip examinations**

If, during the course of a tip examination, the IRS determines that your employees did not report all of their cash tips, then your business will be liable for the employer share of FICA taxes on those unreported tips. I.R.C. § 3121(q). Furthermore, your business may be subject to penalties if the IRS determines that your establishment is an LFBE and you failed to file a Form 8027. Moreover, once a tip examination has begun, IRS auditors are instructed to examine other common employment tax issues such as unreported compensation and worker classification.

If your business employs individuals who receive cash tips, then you should consult with a professional tax adviser regarding employee tip reporting; otherwise, your next special event may be an IRS audit.

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