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**Q:** Does the IRS have a new rule regarding tips at bars and restaurants?

**A:** Yes. Effective January 1, 2014, the IRS will begin to reclassify certain automatic tips as service charges. For example, an 18% gratuity charged to parties of six or more will likely be classified as a service charge rather than a tip.

This will have a significant impact on restaurants, bars, banquet halls, and other food service establishments. Businesses are generally eligible for an income tax credit with respect to the employer share of FICA taxes paid on tips, but not on service charges. Furthermore, service charges and tips are subject to different reporting requirements. Therefore, the new classification will result in added costs for businesses that need to update their payroll systems and policies.

Businesses should consult a tax professional to determine whether to modify their current policies or discontinue automatic gratuities altogether before the new year. Otherwise, that wedding party reservation in the spring might lead to an IRS audit down the road.



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