



# Back Taxes Come Back to Haunt New Tips on Tips

By Dave Poillucci



**U**nderreporting of service gratuity income has long been a concern for the Internal Revenue Service (IRS) and owners and managers of food and beverage establishments.

If employees do not report all of their tip income, the employer not only can be held liable for back FICA taxes, but also can be assessed penalties and interest associated with late payment.

The IRS has implemented compliance programs to assist in the proper reporting of service gratuities, but they often are perceived as burdensome and not very beneficial. A new tip compliance program—Attributed

Tip Income Program (ATIP)—now offers employers in the food and beverage industry a simplified method of reporting and allocating tip income of employees.

Based on a 2002 landmark Supreme Court Case, the IRS has the ability to assess employers for FICA tax on all the tip income of its employees, including any tip income that employees do not report to the employer. Essentially, this court case gave the IRS the authority to assess payroll taxes against the employer on unreported tip income of the employees.

Internal Revenue Code section 6652 allows for a 50 percent penalty on underreported FICA tax due to tip income which could potentially be assessed on taxes representing three or more back years. In some cases, penalties may be assessed on corporate officers, directors or others who had responsibility for the corporate actions.

In 1993 the IRS introduced its Tip Rate Determination/Education Program (TRD/EP), which was designed to enhance tax compliance among tipped employees through taxpayer education and voluntary agreements, instead of traditional audit techniques. The program involves IRS representatives working with employers to educate their employees; the execution of an agreement between the employer and the IRS; and employer participation in one of two tip compliance programs.

However, many employers have been reluctant to enter into the IRS tip programs because they consider the benefits derived to be less than the costs associated with an audit that results in negative findings. Some concerns that employers are faced with when participating in the TRD/EP program are the increased burden of record keeping, the application of an unrealistic tip rate, increased reporting to the IRS and employee retention.

To address some of these concerns, the IRS recently unveiled the Attributed Tip Income Program, a new reporting alternative for employers in the food

and beverage industry. The program was designed by the IRS with the intent to promote compliance by employers and employees with the tax laws governing tip income, to reduce disputes on audit, and to reduce filing and record keeping burdens of employers. ATIP is being offered in addition to the current TRD/EP programs and, like those existing programs, the IRS will not initiate an "employer-only" tip examination during the period the employer participates.

ATIP differs from the existing programs in that it does not require an employer to sign an individual agreement with the IRS and does not require employers to meet with the IRS to determine tip rates or eligibility. Additionally, ATIP significantly reduces the record keeping that is required by the other tip programs and, in many cases, employers will not have to receive and process tip records from participating employees.

Employers that participate in ATIP report the tip income of employees based on a formula that uses a percentage of gross receipts generally allocated among employees based on the practices of the establishment.

To participate in ATIP, employers must make an annual election: their individual establishments must have a minimum level of gross receipts as

charged receipts; a majority of the establishment's tipped employees must agree to participate in the program; and the applied tip rate used by the employer cannot be 2 percent less than the establishment's charge tip rate.

The IRS has made its position clear regarding an employer's responsibility for ensuring accurate tip reporting by its employees, and also the potential tax assessment that employers face based on their employees underreporting tip income.

Is your establishment at risk for back payroll taxes? Are you, as an employer, willing to take on this risk associated with your employees underreporting tip income?

ATIP is completely voluntary and does not alter any of the existing TRD/EP programs. Also, employers currently participating in an existing TRD/EP program may elect to switch to ATIP. ATIP is a three-year pilot program for food and beverage employers and the first annual basis begins January 1, 2007. ▲

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