

## IRS Releases Reminder of Tax Treatment of Tips v Service Charges

The issues in this case include the proper reporting of the “tip” income for payroll tax purposes AND the right to receive the Credit for Employer Social Security and Medicare Taxes Paid on Certain Employee Tips (Form 8846) (Tip Credit).

Several restaurants add a set percentage as a “gratuity” to a customer’s bill, such as when there are six or more at one table, or when a large table wants separate bills, or when there is a banquet or catering event. Many years ago IRS announced the correct treatment of these set percentage amounts. This treatment was repeated in Fact Sheet 2017-8. Here is a summary of these rules.

“Tips” are discretionary and optional payments determined by a customer. A “gratuity” that is a set charge by the business is considered to be a “service fee” as opposed to a “tip.”

### PAYROLL REPORTING

Tips are reported on the Form 941 on line 5b. They are also reported on Form W2 in box 7 as Social Security tips. “Service fees” that are given to employees are considered wages and are reported on Form 941 on line 5a and on the Form W2 in box 3.

### FORM 8846 CREDIT

The Tip Credit is a credit allowed to an employer with tipped employees. The credit amount, briefly, is the amount of FICA taxes paid on the employees’ tips on the “excess tips.” The “excess tips” for this purpose are the amount of tips that exceed the amount of tips needed to bring the wages paid by the employer up to \$5.15 per hour. For example an employer is paying \$4.00 per hour to the tipped employee and the employee had \$3.00 in tips for that hour. \$1.15 of the tips is the amount that takes the employer’s wage of \$4.00 to come up to \$5.15. This leaves \$1.85 of the tips as “excess tips”. On Form 8846 the employer is allowed a credit equal to the FICA taxes paid on this \$1.85.

“Service fees” are also considered wages for purposes of this Form 8846 and are not considered tips. Using the prior example, if these same \$3.00 in “tips” is really a service fee the employer is charging the customer and turning over to the employee, they are really wages and the Form 8846 credit would be based on \$0 since there are no “tips”.

Fact Sheet 2017-8. This Fact Sheet can be found by going to [www.irs.gov](http://www.irs.gov) and typing FACT SHEET in the SEARCH box.

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