

# Tips on Tips

## for Employees Who Receive Tip Income

The tip income you receive as an employee - whether cash or included in a charge - is taxable income. As taxable income, these tips are subject to federal income tax, social security and Medicare taxes, and may be subject to state income tax as well. This guide can aid the employee who may need answers to tip income reporting questions.

**Do I have to report all my tips to my boss?**

If you received \$20.00 or more in tips in any one month, you should report all your tips to your employer so that federal income tax, social security and Medicare taxes, and maybe state income tax can be withheld.

**Do I have to report all my tips on my tax return?**

Yes. All tips are taxable income and should be reported on your tax return.

**I was told that I had to report only a certain percentage of my total sales as tips. Is this true?**

No. You must report to your employer all (100%) tips you receive, except for the tips from any month that do not total at least \$20.00.

**Sometimes I don't get tips directly from customers, but rather from another employee. Do I need to report those tips?**

Yes. Employees who receive tips from another employee are required to report "tip-outs." Employees often disburse tips out of their earned tips to another employee (tip-outs). Remember, all tips are taxable income.

**Do I have to report tip-outs that I pay to other employees?**

No. You report to your employer only the amount of tips you retain. However, you must maintain records of tipouts with your other tip income (cash tips, charged tips, split tips, tip pool).

**What type of records do I have to keep?**

You must keep a running daily log of all your tip income. You can use Publication 1244, *Employee's Daily Record of Tips and Report to Employer*, to record your tip income for one year. Publication 1244 includes Form 4070, *Employee's Report of Tips to Employer*, and Form 4070A, *Employee's Daily Record of Tips*. These forms have spacing for you to log your name, the employer's name and address, date tips were received, date of entry, tips received, tips paid out, and name of employee paid. Your daily log would be your best proof should your income tax return be questioned. For a free copy of Publication 1244, call the IRS at 1-800-829-3676.

**What can happen if I do not keep a record of my tips?**

If it is determined in an examination that you underreported your tip income, the IRS will assess the taxes you owe based on the best available records of your employer. Tip income adds up. Underreporting could result in you owing substantial taxes, penalties, and interest.

**If I report all my tips to my employer, do I still have to keep records?**

Yes. You should keep a daily log of your tips so that in case of an examination, you can substantiate the actual amount of tips received. There are a number of reasons why you might need records:  
 - Your return could be randomly selected for a federal income tax examination. For example: Your Form 1040, *U.S. Individual Income Tax Return*, establishes that you have your own home, two cars, and three exemptions, and your Form W-2 shows that you earned

only \$10,000 in income. In this scenario, an examination may occur if the examiner determines that income may have been underreported.  
 - A tip examiner could review your employer's books and records. The examination could reveal unreported tip income that you may later need to verify.  
 - An Internal Revenue Service Center may run a match of your income information from your Form 1040, *U.S. Individual Income Tax Return*, with the income information from your Form W-2. If these figures do not match, you could receive a notice about the discrepancy and a possible examination of your tax return.

**I forgot to report my tip income to my employer, but I remembered to record it on my federal income tax return. Will that present a problem?**

If you do not report your tip income to your employer, but you do record the tip income on your federal income tax return, you may owe a 50% social security and Medicare tax penalty and be subject to a negligence penalty and possibly an estimated tax penalty. When you do not report your tips to your employer, it places your employer at risk of possible assessment of the employer's share of social security and Medicare taxes.

**If I report all my tips but my taxes on the tips are greater than my pay from my employer, how do I pay the remaining taxes?**

You can either pay the tax when you file your federal income tax return or you can reach into your tip money and give some to your employer to be applied to those under-withheld taxes. The employer will then record these taxes and you will get credit on your Form W-2. If you wait to pay when you file your tax return, you may be subject to an estimated tax penalty.

**What can happen if I don't report my tips to the IRS?**

If the IRS determines through an examination that you underreported your tips, you could be subject to additional federal income tax, social security and Medicare taxes, and maybe state income tax. Also, a penalty of 50% of the additional social security and Medicare taxes, and a negligence penalty of 20% of the additional income tax, plus interest, may apply.

**What's in it for me if I report all my tip income?**

There are many good reasons why you want to report all your tip income:  
 - Increased income may improve financing approval when applying for larger loan amounts (mortgage, car, and other loans)  
 - Increased worker's compensation benefits, should you get hurt on the job  
 - Increased unemployment compensation benefits  
 - Increased social security and Medicare benefits (the more you pay, the greater your benefits)  
 - Increased employee pension, annuity, or 401(k) participation  
 - Check with your employer for other increased benefits (based on pay) that your company may offer, such as life insurance, disability payments, and the right to purchase stock options  
 - Compliance with the tax law

See Publication 531, *Reporting Tip Income*, for further information.