

IRS News Release

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Tips Versus Service Charges: How to Report

FS-2015-8, February 2015

The Internal Revenue Service reminds employers that automatic gratuities are service charges, not tips. Employers should make sure they know the difference and how they report each to the IRS. What are tips?

Tips are discretionary (optional or extra) payments determined by a customer that employees receive from customers.

Tips include:

- Cash tips received directly from customers.
- Tips from customers who leave a tip through electronic settlement or payment. This includes a credit card, debit card, gift card, or any other electronic payment method.
- The value of any noncash tips, such as tickets, or other items of value.
- Tip amounts received from other employees paid out through tip pools or tip splitting, or other formal or informal tip sharing arrangement.

Certain factors are used to determine whether payments constitute tips or service charges. The absence of any of the following factors creates a doubt as to whether a payment is a tip and indicates that the payment may be a service charge:

- The payment must be made free from compulsion;
- The customer must have the unrestricted right to determine the amount;
- The payment should not be the subject of negotiations or dictated by employer policy; and
- Generally, the customer has the right to determine who receives the payment.

What are service charges?

An employer or employee's characterization of a payment as a "tip" is not determinative. Again, the absence of any of the four factors listed earlier creates a doubt as to whether a payment is a tip and indicates that the payment may be a service charge.

Examples of service charges commonly added to a customer's check include:

- Large dining party automatic gratuity
- Banquet event fee
- Cruise trip package fee
- Hotel room service charge
- Bottle service charge (nightclubs, restaurants)

Generally, service charges are reported as non-tip wages paid to the employee. Some employers keep a portion of the service charges. Only the amounts distributed to employees are non-tip wages.

How are each reported?

Reporting Tips

Employees must report to their employer all cash tips received except for the tips from any month that total less than \$20. Cash tips include tips received from customers, charged tips (for example, credit and debit card charges) distributed to the employee by his or her employer, and tips received from other employees under any tip-sharing arrangement. Non-cash tips (that is, tips received by an employee in any other medium than cash, such as passes, tickets, or other goods or commodities) from customers are not reported to the employer. All cash tips and non-cash tips are includable in an employee's gross income and subject to federal income taxes.

Both directly and indirectly tipped employees must report tips to their employer.

A "directly tipped employee" is any employee who receives tips directly from customers, including one who after receiving the tips turns all of them over to a tip pool. Examples of directly tipped employees are waiters, waitresses, bartenders, and hairstylists.

An "indirectly tipped employee" is a tipped employee who does not normally receive tips directly from customers. Examples of indirectly tipped employees are bussers, service bartenders, cooks, and salon shampooers.

Employers are required to retain employee tip reports, withhold employee income taxes and the employee share of social security and Medicare taxes based upon wages and tip income received, and then report this information to the IRS. In addition, employers are required to pay the employer share of Social Security and Medicare taxes based on the total wages paid to tipped employees as well as the reported tip income.

Tips reported to the employer by the employee must be included in Box 1 (Wages, tips, other compensation), Box 5 (Medicare wages and tips), and Box 7 (Social

security tips) of the employee's Form W-2, Wage and Tax Statement. Enter the amount of any uncollected social security tax and Medicare tax in Box 12 of Form W-2. See the General Instructions for Forms W-2 and W-3.

For more information, including what to do if there are not enough wages to withhold all of the taxes, see Topic 761 - Tips – Withholding and Reporting.

Reporting Service Charges

Employers who distribute service charges to employees should treat them the same as regular wages for tax withholding and filing requirements as provided in Publication 15 (Circular E), Employer's Tax Guide.

Online Help Available

- [IRS.gov/Help-&-Resources](https://www.irs.gov/help-and-resources)
 - IRS Tip Program - E-mail Tip.Program@irs.gov
- [Publication 531](#), Reporting Tip Income: This publication is for employees who receive tips.
- [Publication 1244](#), Employee's Daily Record of Tips and Report to Employer
- [Publication 15](#) (Circular E), Employer's Tax Guide
- [Revenue Ruling 2012-18](#)