



MANUAL TRANSMITTAL

Department of the Treasury
Internal Revenue Service

4.23.7

MAY 10, 2021

EFFECTIVE DATE

(05-10-2021)

PURPOSE

- (1) This transmits revised IRM 4.23.7, Employment Tax, Employment Tax on Tip Income.

MATERIAL CHANGES

- (1) IRM 4.23.7.1. Deleted Overview and replaced with new subsection, Program Scope. Rearranged existing IRM content to place information involving internal controls for a program IRM under this subsection to conform to the new rules to ensure that the program's internal controls are adequately expressed in the IRM.
- (2) IRM 4.23.7.1.1. New subsection, Background.
- (3) IRM 4.23.7.1.2. New subsection, Authority.
- (4) IRM 4.23.7.1.3. New subsection, Responsibilities.
- (5) IRM 4.23.7.1.4. New subsection, Program Objectives & Review.
- (6) IRM 4.23.7.1.5. New subsection, Acronyms.
- (7) IRM 4.23.7.1.6. New subsection, Related Resources.
- (8) IRM 4.23.7.4.1 (7). Changed Service Representatives to Examiners.
- (9) IRM 4.23.7.4.1 (8). Changed three attachments to four, adding the Notice 609 to the list of documents to be mailed with Letter 4520-P. Updated FAQs to include the publication name, Publication 5080.
- (10) IRM 4.23.7.4.1 (10). Changed three attachments to two, removing Publication 5080 FAQs as they were already mailed with the Letter 4520-P, the Section 3121(q) Pre-notice for Employer Share of Tax Based on Form 4137.
- (11) IRM 4.23.7.4.1 (11). Removed **business** from the statement, "The date of the Section 3121(q) Notice and Demand will be the last day of the quarter in which the Letter 4520 is issued, not the mailing date of the letter". Should be the last day of the quarter.
- (12) IRM 4.23.7.7 (6-11). New sections adding information on the scope of a tip audit, incorporating Interim Guidance Memorandum SBSE-04-0720-0059, issued July 26, 2020, Interim Guidance on the Requirement to Consider Expanding the Scope of an Examination Selected and Assigned as a Tip Audit Case. Includes additional instructions.
- (13) IRM 4.23.7.7.1. Subsection title changed to Scope of Tip Examination and deleted (1).
- (14) IRM 4.23.7.7.2.
- (15) IRM 4.23.7.7.3 (5). Updated IRM reference from 4.23.10.6 to 4.23.10.5.
- (16) IRM 4.23.7.7.4 (6). Removed **business** from the statement, "Therefore, the date on the Section 3121(q) Notice and Demand should be postdated with the last business day of the quarter." Updated example to read the date as March 31, 2012 (not 30).

- (17) IRM 4.23.7.7.4 (15). Added Exhibit “1” to Exhibit 2 of IRM 4.9.1.
- (18) IRM 4.23.7.7.5 (2). Reworded and form number 14439 added.
- (19) IRM 4.23.7.7.5 (5). Updated IRM reference from 4.23.6.19 to 4.23.6.18.
- (20) IRM 4.23.7.7.5 (9). Updated IRM reference from 21.6.4.4.14.6 to 4.5.1.
- (21) IRM 4.23.7.8 (2). Updated IRM reference from 4.19.15.29 to 4.19.15.26.
- (22) Exhibit 4.23.7.10 (1). Modified statement to read, “The Tip Rate Determination and Education Program (TRD/EP) was designed to promote compliance by industry employers and employees with the provisions of the Internal Revenue Code relating to tip income and to reduce disputes under Section 3121(q). The TRD/EP was established in the early 1990’s. Tip Agreements were designed to enhance administration of the tip program by both the Employer and the IRS and to facilitate and promote the use of current financial information technology in the tip reporting process.” This statement provides the history and introduces the voluntary compliance feature available in the tip industry.
- (23) IRM 4.23.7.10.2. Changes made to the solicitation and securing of tip agreements.
- (24) IRM 4.23.7.10.4. Examples included on revocation of tip agreement.
- (25) New subsections 4.23.7.10.6.3 to 4.23.7.10.6.21 are replacing 4.23.7.10.6.3, 4.23.7.10.6.4, and 4.23.7.10.6.5, as well as 4.23.7.11. Please see the current list below.

New IRM 4.23.7 Subsection	New IRM 4.23.7 Subsection Title
4.23.7.10.6.3	Tip Rate Review Background
4.23.7.10.6.4	Control of Cases and Establishment of Cases
4.23.7.10.6.5	Issue Management System (IMS)
4.23.7.10.6.6	Tip Review Employment Tax Lead Sheets (ETLS)
4.23.7.10.6.7	Rate Review Procedures
4.23.7.10.6.7.1	Completion of the templates
4.23.7.10.6.8	Criteria to be Considered Tip Income
4.23.7.10.6.9	Working Newly Opened Properties or Outlets versus Existing Properties
4.23.7.10.6.10	Pre-Contact Analysis and Research
4.23.7.10.6.11	Initial Contact and Tour of Business
4.23.7.10.6.12	Initial Interview
4.23.7.10.6.13	Information Document Requests
4.23.7.10.6.14	Templates and Parameters
4.23.7.10.6.15	Point of Sales (POS) Reports
4.23.7.10.6.16	Payroll Requests and Certification
4.23.7.10.6.17	Review of Internal Controls

New IRM 4.23.7 Subsection	New IRM 4.23.7 Subsection Title
4.23.7.10.6.18	Analysis and Approval of Calculated Rates
4.23.7.10.6.19	Completion of Agreement
4.23.7.10.6.20	Case Closing
4.23.7.10.6.21	Case File Assembly

- (26) The following IRM sections were renumbered resulting from edits, additions and/or replacement of previous sections:

Previous IRM 4.23.7 Section	New IRM 4.23.7 Section
4.23.7.13 - Petition for Lower Rate	4.23.7.12
4.23.7.13.1 - Procedures for Tip Rate Reduction Petitions	4.23.7.12.1
4.23.7.14 - Employment Tax Monitoring Unit	4.23.7.13

- (27) 4.23.7.10.6.22 New sections adding information on procedures for conducting a tip rate renewal review, incorporating Interim Guidance Memorandum SBSE-04-0719-0032, issued July 26, 2020, Interim Guidance on the a GITCA Renewal Without a Full Rate Review. Includes additional instructions.
- (28) 4.23.7.11(9-18) New sections adding information on procedures on conducting a tip compliance review, incorporating Interim Guidance Memorandum SBSE-04-0919-0041, issued September 17, 2019, Interim Guidance on the Procedures to Conduct a Tip Agreement Compliance Review. Includes additional instructions.
- (29) Exhibit 4.23.7-3. New exhibit, NTRCP Letters, Publications and Forms added.
- (30) Editorial, typographical, and technical changes have been made throughout the section.

EFFECT ON OTHER DOCUMENTS

This material supersedes IRM 4.23.7, dated January 13, 2014. This section incorporates the following Interim Guidance Memorandums:

SBSE-04-0720-0059, issued July 26, 2020, Interim Guidance on the Requirement to Consider Expanding the Scope of an Examination Selected and Assigned as a Tip Audit Case.

SBSE-04-0719-0032, issued July 26, 2020, Interim Guidance on the a GITCA Renewal Without a Full Rate Review, and

SBSE-04-0919-0041, issued September 17, 2019, Interim Guidance on the Procedures to Conduct a Tip Agreement Compliance Review.

AUDIENCE

This section contains instructions and guidelines for all LB&I, TE/GE, and SB/SE employees when dealing with employment tax tip issues.

Alfredo Valdespino
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Small Business/Self-Employed Division

4.23.7

Employment Tax on Tip Income

Table of Contents

4.23.7.1 Program Scope and Objectives

4.23.7.1.1 Background

4.23.7.1.2 Authority

4.23.7.1.3 Responsibilities

4.23.7.1.4 Program Objectives and Review

4.23.7.1.5 Acronyms

4.23.7.1.6 Related Resources

4.23.7.2 Introduction

4.23.7.3 Employee Tip Reporting

4.23.7.3.1 Railroad Retirement Tax on Tip Income

4.23.7.4 Form 4137 Requirements

4.23.7.4.1 Form 4137 Compliance Program

4.23.7.5 Information Return Reporting

4.23.7.5.1 Form 8027 Requirements

4.23.7.5.2 Form 8027 Allocated Tips

4.23.7.6 Other Information Reporting Issues to Review

4.23.7.6.1 Payments to Drivers of Taxicabs, Limousines, Tour Buses, and Other Modes of Transportation for Services

4.23.7.6.2 Tips vs. Service Charges

4.23.7.6.3 Prospective Treatment of Revenue Ruling 2012-18, Tips vs. Service Charges

4.23.7.7 Employment Tax Tip Examination

4.23.7.7.1 Scope of Tip Examination

4.23.7.7.2 Employer Tip Examinations

4.23.7.7.3 Report Writing Procedures for Tip Examinations

4.23.7.7.4 Section 3121(q) Notice and Demand Procedures

4.23.7.7.5 Employee Tip Examination

4.23.7.8 Statute of Limitations for Tip Examinations

4.23.7.8.1 Extending Statute of Limitations for Tip Examinations of Employees (Form 1040)

4.23.7.9 IRC Section 45B Credit

4.23.7.10 Tip Rate Determination and Education Program (TRD/EP)

4.23.7.10.1 Tip Compliance Agreements

4.23.7.10.2 Solicitation of Tip Compliance Agreements

4.23.7.10.3 Tip Rate Determination Agreement (TRDA)

4.23.7.10.3.1 Revoking TRDA Agreements

4.23.7.10.4 Tip Reporting Alternative Commitment (TRAC)

-
- 4.23.7.10.4.1 Revoking TRAC Agreements
 - 4.23.7.10.5 EmTRAC – (Employer-designed TRAC) Program
 - 4.23.7.10.6 Gaming Industry Tip Compliance Agreement (GITCA)
 - 4.23.7.10.6.1 GITCA Background
 - 4.23.7.10.6.2 Gaming Industry Tip Compliance Agreement (GITCA) Benefits and Responsibilities
 - 4.23.7.10.6.2.1 Employer’s Benefits and Responsibilities
 - 4.23.7.10.6.2.2 Employee’s Benefits and Responsibilities
 - 4.23.7.10.6.2.3 IRS Benefits and Responsibilities
 - 4.23.7.10.6.2.4 Mutual Responsibilities between the Employer and the IRS
 - 4.23.7.10.6.3 Tip Rate Review Background
 - 4.23.7.10.6.4 Control of Cases and Establishment of Cases
 - 4.23.7.10.6.5 Issue Management System (IMS)
 - 4.23.7.10.6.6 Tip Review Employment Tax Lead Sheets (ETLS)
 - 4.23.7.10.6.7 Rate Review Procedures
 - 4.23.7.10.6.7.1 Completion of the Templates
 - 4.23.7.10.6.8 Criteria to be Considered Tip Income
 - 4.23.7.10.6.9 Working Newly Opened Properties or Outlets versus Existing Properties
 - 4.23.7.10.6.10 Pre-Contact Analysis and Research For Tip Agreements
 - 4.23.7.10.6.11 Initial Contact and Tour of Business
 - 4.23.7.10.6.12 Initial Interview
 - 4.23.7.10.6.13 Information Document Requests
 - 4.23.7.10.6.14 Templates and Parameters
 - 4.23.7.10.6.15 Point of Sales Reports
 - 4.23.7.10.6.16 Payroll Requests and Certification
 - 4.23.7.10.6.17 Review of Internal Controls
 - 4.23.7.10.6.18 Analysis and Approval of Calculated Rates
 - 4.23.7.10.6.19 Completion of Agreement
 - 4.23.7.10.6.20 Case Closing
 - 4.23.7.10.6.21 Case File Assembly
 - 4.23.7.10.6.22 GITCA Renewal Without Full Rate Review
 - 4.23.7.11 Mandatory Compliance Follow-Up Reviews on Voluntary Tip Agreements
 - 4.23.7.12 Petition for Lower Rate
 - 4.23.7.12.1 Procedures for Tip Rate Reduction Petitions
 - 4.23.7.13 Employment Tax Monitoring Unit

Exhibits

- 4.23.7-1 Codes to Complete Form 5345-NTRC
- 4.23.7-2 Chart of Tip Report Writing Instructions
- 4.23.7-3 Letters, Publications, and Forms

4.23.7.1
(05-10-2021)
Program Scope and Objectives

- (1) **Purpose:** This section details the basic structure of Tip Examinations and the Tip Rate Review process.
- (2) **Audience:** This section contains instructions and guidelines for all Large Business and International (LB&I), Tax Exempt/Government Entities (TE/GE), and Small Business/Self-Employed (SB/SE) employees dealing with Tip Examinations and Tip Rate Review procedures.
- (3) **Policy Owner:** Director, Examination - Specialty Policy of the Small Business/Self-Employed Division.
- (4) **Program Owner:** Program Manager – National Tip Reporting Compliance Program (NTRCP).

4.23.7.1.1
(05-10-2021)
Background

- (1) The mission of Employment Tax National Tip Reporting Compliance Program (NTRCP) Territory is to develop and implement policies and strategies for tip income filing, payment (withholding), and reporting compliance.
- (2) Tipping has been a historical area of underreporting and is subject to unique laws and regulations. Traditional examinations often are burdensome to both the taxpayer and the Service. NTRCP has developed voluntary tools, most predominantly tip agreements, which address employer and employee compliance.
- (3) This section provides guidance on general tip examinations and voluntary compliance tools for taxpayers in the tipping industry. Examiners should also refer to tip training materials for additional guidance.

4.23.7.1.2
(05-10-2021)
Authority

- (1) Employment tax provisions are found at Internal Revenue Code Subtitle C:
 - a. Chapter 21, Federal Insurance Contributions Act (FICA)
 - b. Chapter 22, Railroad Retirement Tax Act (RRTA)
 - c. Chapter 23, Federal Unemployment Tax Act (FUTA)
 - d. Chapter 24, Federal Income Tax Withholding (FITW)
 - e. Chapter 25, General Provisions relating to employment taxes and collection of income taxes at source
- (2) NTRCP is governed by Policy Statements and other internal guidance that apply to all IRS personnel regardless of operating division. The Policy Statements found in IRM 1.21, Servicewide Policies and Authorities, Policies of the Internal Revenue Service, apply to all employment tax issues and examinations. Reviewers should review these Policy Statements to properly perform their examination duties.
- (3) A website, *Delegation Orders and Policy Statements by Process*, summarizes data contained in the applicable IRM sections under IRM 1.21, Servicewide Policies and Authorities, relating to Delegation Orders, in a single, electronic source.
- (4) IRM 4.23.7.10.6, Gaming Industry Tip Compliance Agreement (GITCA), provides Servicewide instructions for all operating divisions with employees involved with Tip Rate Reviews, allowing for improved consistency of tip administration of employment taxes=.

4.23.7.1.3
(05-10-2021)
Responsibilities

- (1) Director, Specialty Examination, is the executive responsible for the procedures and updates addressed in this IRM.
- (2) Chief, Employment Tax Examination, is responsible for operational compliance related to tip filing and reporting.

4.23.7.1.4
(05-10-2021)
Program Objectives and Review

- (1) Program Goals: The processes and procedures provided in this IRM are consistent with the objectives or goals for National Tip Reporting Compliance. The mission of NTRCP is to establish effective policies and procedures for tip income filing, payment, and reporting compliance. This is accomplished through enforcement and compliance programs such as Tip Examinations and Tip Rate Reviews.
- (2) Program Effectiveness: Adherence to quality standards and attributes are measured by Employment Tax Embedded Quality (EQ) Performance Reports. Progress toward business results is measured by Performance Planning and Analysis (PPA) Exam reports.

4.23.7.1.5
(05-10-2021)
Acronyms

- (1) The following table lists commonly used acronyms and their definitions:

Term	Definition
ETLS	Employment Tax Lead Sheets
ET-WSD	Employment Tax - Workload Selection and Delivery unit
EQ	Embedded Quality
FICA	Federal Insurance Contributions Act
FITW	Federal Income Tax Withholding
FUTA	Federal Unemployment Tax Act
GITCA	Gaming Industry Tip Compliance Agreement
IMS	Issue Management System
IRA	Individual Retirement Account
IRM	Internal Revenue Manual
ITG	Indian Tribal Governments
LBandI	Large Business and International
NTRCP	National Tip Reporting Compliance Program
MOU	Memorandum of Understanding
POS	Point of Sale
PPA	Performance Planning and Analyst
RRTA	Railroad Retirement Tax Act
SB/SE	Small Business/Self-Employed
SERP	Servicewide Electronic Research Program

Term	Definition
SRS	Specialist Referral System
SSA	Social Security Administration
TBOR	Taxpayer Bill of Rights
TE/GE	Tax Exempt/Government Entities
TEPA	Tipped Employee Participation Agreement
TRAC	Tip Reporting Alternative Commitment
EmTRAC	Employer-designed Tip Reporting Alternative Commitment
TRD/EP	Tip Rate Determination and Education Program
TRDA	Tip Rate Determination Agreement

4.23.7.1.6
(05-10-2021)
Related Resources

(1) The following table lists the primary sources of guidance:

Source	Title	Description of Guidance
IRM 4.23	Employment Tax IRM	IRM sections, the majority of which are owned by SB/SE - Specialty Examination Policy, provide Servicewide instructions for employees of all operating divisions involved with the correct filing, reporting, and payment of employment taxes. IRM 4.23 serves as the foundation for consistent administration of employment taxes by various IRS operating divisions.

(2) Other helpful information sources include:

- The SB/SE Knowledge Management home page for Employment Taxes <https://portal.ds.irsnet.gov/sites/VL014/Pages/default.aspx>.
- The Specialist Referral System home page: <https://srs.web.irs.gov/>.
- A list of SB/SE Employment Tax Policy Analysts, their contact information and program assignments, are found at: *Policy Analyst Listing*.

- The web site “Examining an Employment Tax Case” at: <https://portal.ds.irsnet.gov/sites/vl014/pages/home.aspx?bookshelf=examining%20an%20employment%20tax%20case>.

- (3) The Taxpayer Bill of Rights (TBOR) lists rights that already existed in the tax code, putting them in simple language and grouping them into 10 fundamental rights. Employees are responsible for being familiar with and acting in accord with taxpayer rights. See IRC 7803(a)(3), Execution of Duties in Accord with Taxpayer Rights. For additional information about the TBOR. See IRC 7803(a)(3). For additional information about TBOR, see <https://www.irs.gov/taxpayer-bill-of-rights>.
- (4) The Taxpayer Advocate Service (TAS) is an independent organization within the IRS whose employees assist taxpayers experiencing economic harm, who are seeking help in resolving tax problems that have not been resolved through normal procedures, or who believe that an IRS system or procedure is not working as it should. Pub 1546, Taxpayer Advocate Service - We Are Here to Help You, provides contact and additional information. The program is designed to alleviate taxpayer hardships that arise from systemic problems or the application of the Internal Revenue Code. In addition, see IRM 13.1.7, Taxpayer Advocate Service (TAS) Case Criteria, and IRM 13.1.19, TAS Operations Assistance Request (OAR) Process, for additional information.
- (5) Employment tax examiners should consider the disclosure provisions when preparing agreed and unagreed case reports. See the Disclosure and Privacy Knowledge Management web site at: <https://portal.ds.irsnet.gov/sites/VL003/Pages/default.aspx> for additional information.

4.23.7.2 (01-13-2014) Introduction

- (1) Under Treas. Reg. 31.3102–3, the employer is responsible for deducting and depositing the employee’s share of social security and Medicare tax on tips. All tips should be included in a written report furnished by the employee to the employer. The employer must withhold to the extent that collection can be made from the employee’s funds on or after the time the written statement is furnished. The employee’s funds include wages (exclusive of tips) in the employer’s possession and amounts turned over to the employer by the employee.
- (2) If the employee does not provide enough money, the employer will apply the employee’s regular pay and any money the employee gives to the employer to the taxes in the following order:
 - a. Social security and Medicare or railroad retirement taxes on the employee’s regular wages,
 - b. Federal, state, and local income taxes on the employee’s regular wages,
 - c. Social security and Medicare taxes or railroad retirement taxes on the employee’s reported tips, and
 - d. Federal, state, and local income taxes on the employee’s reported tips.

Any taxes that remain unpaid can be collected by the employer from the employee’s next paycheck. If withholding taxes remain uncollected at the end of the year, the employee may be subject to a penalty for underpayment of estimated taxes.

- (3) IRC 3121(q) provides that employers must pay the employer’s share of social security and Medicare taxes on tips reported by their employees in the course of employment. The tips are deemed to have been paid at a time a written

statement including such tips is furnished by the employee to the employer. If no such statement is furnished (or to the extent the statement is incomplete or inaccurate) the tips will be deemed to be paid on the date on which Section 3121(q) Notice and Demand for the taxes is made to the employer. (See IRM 4.23.7.7.4, Section 3121(q) Notice and Demand Procedures, below).

- (4) For income tax purposes, tips are wages that are deemed paid at the time a written statement including such tips is furnished to the employer pursuant to IRC 6053(a) or, if no statement including such tips is so furnished, at the time received. Employers are required to withhold federal income tax on tips listed on the employee's written statement.
- (5) The employer is required to furnish a statement to the employee showing the amount of social security and Medicare taxes that could not be collected from the employee's wages. Form W-2 is the form prescribed for furnishing this statement under Treas. Reg. 31.6053-2(b). Unlike the uncollected portion of the regular (1.45 percent) Medicare tax, the uncollected Additional Medicare Tax (0.9 percent) is not reported on Form W-2. The employer shows the uncollected social security tax, Medicare tax, and Additional Medicare Tax as a current period adjustment on the employer's employment tax return, (e.g., Form 941, Employer's QUARTERLY Federal Tax Return).

Note: For tax years beginning after December 31, 2012, a 0.9 percent Additional Medicare Tax applies to Medicare wages, Railroad Retirement Tax Act compensation, and self-employment income over a threshold amount based on the taxpayer's filing status. For more information on Additional Medicare Tax, go to IRS.gov and enter "Additional Medicare Tax" in the search box.

4.23.7.3
(12-18-2012)
Employee Tip Reporting

- (1) IRC 6053(a) requires that the employee provide the written statement of tip income to the employer by the 10th day of the month following employee's receipt of the tips, if reportable. No particular form is required to be used in reporting tip income. Treas. Reg. 31.6053-1 requires that the form used should be signed by the employee and disclose:
 - a. The name, address, and social security number of the employee,
 - b. The name and address of the employer,
 - c. The total amount of tip income, and
 - d. The period for which, and the date on which, the statement is furnished. If the statement is for a calendar month, the month and year should be specified. If the statement is for a period of less than one calendar month, the beginning and ending dates of the period should be shown (for example, Jan. 1 through Jan. 8, 2020).
- (2) Employees may use Form 4070, Employee's Report of Tips to Employer, along with Form 4070A, Employee's Daily Record of Tips, for the written statement of tip income. Form 4070 and Form 4070A are included in Publication 1244, Employee's Daily Record of Tips and Report of Tips to Employer.

Note: Some employers may require employees to use an employer-provided form.

- (3) In lieu of a separate form for tip reporting, Treas. Reg. 31.6053-1(b)(2)(iii) provides that an employer may prescribe regularly used forms (such as timecards) for use by employees in reporting tips. However, the form must

meet the requirements of Treas. Reg. 31.6053-1(b)(1)(iii) and (iv) and must contain identifying information which will assure accurate identification of the employee by the employer.

- (4) An employer may prescribe regularly used electronic forms for use by employees for reporting tips. If an electronic statement is used, the electronic system must ensure that the information received is the information transmitted by the employee. The system must document all occasions of access that result in the transmission of a tip statement. In addition, the design and operation of the electronic system, including access procedures, must make it reasonably certain that the person accessing the system and transmitting the statement is the employee identified in the statement transmitted. Any electronic statement must include the same information set out above in paragraph (1). An electronic tip statement must be signed by the employee. The electronic signature must identify the employee transmitting the electronic tip statement and must authenticate and verify the transmission. Upon request by the IRS, the employer must supply the IRS with a hard copy of the electronic tip statement and a statement that, to the best of the employer's knowledge, the electronic tip statement was filed by the named employee. Treas. Reg. 31.6053-1(d).
- (5) If an employee does not report all cash tips (cash tips include tips received from customers), charged tips (credit and debit card charges) distributed to employees by employer, and tips received from other employees (under any tip-sharing arrangement) to the employer in a written statement, the employee may be subject to the penalty imposed by IRC 6652(b), Failure to Report Tips.
- (6) The cash tips to which this provision applies include checks and any other monetary media of exchange. Tips received by an employee in any medium other than cash, such as passes, tickets, or other goods or commodities, do not constitute wages for FICA purposes. See Treas. Reg. 31.3121(a)(12)-1.
- (7) If an employee fails to maintain records, or if the records kept do not accurately reflect the amount of tip income received, the IRS is authorized, under IRC 446(b), to reconstruct income in accordance with any method that in its opinion clearly reflects the amount of tip income received.
- (8) The employee is responsible for reporting **all** tip income on his or her Form 1040. Tip income includes cash tips (see IRM 4.23.7.7.3(3), Employee Tip Reporting, above) and the value of tips not paid in cash, for example passes, tickets, goods, or services. These non-cash tips are not included in the Form W-2 but must be reported for Federal income tax purposes on the employee's Form 1040.

4.23.7.3.1
(01-22-2010)
**Railroad Retirement Tax
on Tip Income**

- (1) For employees subject to the Railroad Retirement Tax Act, examiners should include in the explanation of adjustments portion of the audit report the following statement, "Changes to amount of wages subject to railroad retirement tax will be reported to the Railroad Retirement Board."
- (2) After completing the examination, prepare a memorandum addressed to:
Chief Financial Officer
Railroad Retirement Board
844 Rush Street North
Chicago, IL 60611

- (3) Attach the memorandum to the Form 3198, Special Handling Notice, and place on outside of case file where it will remain as the file is processed. Enter notation "RRTA Tax on Tips" on line "Other."
- (4) This memorandum will include employee's name, social security number, name of railroad employer, and the yearly increases or decreases to amounts subject to railroad retirement tax.

4.23.7.4 (01-13-2014) **Form 4137 Requirements**

- (1) Form 4137, Social Security and Medicare Tax on Unreported Tip Income, is used by an employee to compute the social security and Medicare tax owed on tips not reported to the employer. Unreported tip income, reported on Form 4137, is carried over to Form 8959, Additional Medicare Tax, which is used by an employee to compute Additional Medicare Tax owed on tips not reported to the employer. Unreported tips may include allocated tips shown on the employee's Form W-2, Wage and Tax Statement, Box 8, (unless the employee can prove a smaller amount with adequate records). The employee may be subject to a penalty equal to 50 percent of the social security tax, Medicare tax, and Additional Medicare Tax due for failure to report tips to the employer unless reasonable cause exists (IRC 6652(b)). The Form 4137 and Form 8959 are filed with the Form 1040, Individual Income Tax Return.

4.23.7.4.1 (05-10-2021) **Form 4137 Compliance Program**

- (1) Form 4137 is designed to be used exclusively by employees to calculate the social security and Medicare taxes on unreported tips. Prior to 2007, Form 4137 was also used by employees to report Form 1099 income that they believed were wages rather than non-employee compensation. Starting with tax year 2007, Form 8919, Uncollected Social Security and Medicare Tax on Wages, is used for that purpose.
- (2) Form 4137 shows the individual EIN(s) and the employee's unreported tips for each of the employers for whom the employee worked for during the year. Form 4137 allows the IRS to aggregate unreported tips reported on Forms 4137 for each employer. This allows the IRS to provide each employer with a Section 3121(q) Notice and Demand for the employer's share of the applicable FICA due on the tips their employees reported to the IRS but did not report to the employer.
- (3) IRC 3121(q) provides the authority for the IRS to issue a Section 3121(q) Notice and Demand to an employer for the employer's share of FICA tax on unreported tips – determined either by tip examination or from Form(s) 4137 filed by employees. Detailed guidance related to the Section 3121(q) Notice and Demand process for tip exams is covered in IRM 4.23.7.7.4, Section 3121(q) Notice and Demand Procedures.
- (4) The Form 4137 Compliance Program is designed to determine the total tips shown as unreported on Form 4137 for each employer and then issue a Section 3121(q) Notice and Demand for the payment of the employer's share of FICA tax on those tips. This program is administered by NTRCP within SB/SE Employment Tax.
- (5) The Section 3121(q) Notice and Demand process related to Form 4137 is not considered an examination. The employer's (taxpayer's) books and records are not examined. The Section 3121(q) Notice and Demand process is a collection program – collecting the employer's share of FICA taxes related to unreported tips shown on the Forms 4137 with each respective employer through a current period liability to the employer's Form 941, Employer's Quarterly

Federal Tax Return. No specific format is required for the notice and demand, but the IRS has developed correspondence for making the notice and demand.

- (6) Each case is established on AIMS using the following codes:
- Project Code 1034: 4137 Tip Correspondence Contacts
 - Tracking Code 7887: 4137 Leads
- (7) Examiners must use Letter 4520-P, Pre-notice for Employer Share of Tax Based on Form 4137, to provide the employer with advance notice of the IRC 3121(q) FICA tax liability. Generally, the IRS will send the employer the pre-notice at least thirty days prior to issuing the Section 3121(q) Notice and Demand to allow the employer sufficient time to gather the necessary funds for making a timely tax deposit.

Note: Letter 4520-P emphasizes to the employer that if a payroll service is used, the employer should immediately notify the payroll service of the IRC 3121(q) FICA tax liability. The payroll service provider may need time to work with the employer so the necessary payroll deposit can be made timely and thus reduce or eliminate any interest or deposit penalties.

- (8) There are four attachments to Letter 4520-P:
- a. **Tax calculation worksheet:** Summarizes the IRC 3121(q) FICA tax liability due,
 - b. **Form 4137 detail spreadsheet:** Lists information from each of the Form(s) 4137 filed under the employer's EIN (employer identification number), and
 - c. **Publication 5080 FAQs:** Provide guidance for the most commonly asked questions.
 - d. **Notice 609:** Informs individuals of their privacy rights in non-criminal cases,

Note: It is recommended that Examiners issue the Section 3121(q) Notice and Demand within the first 60 days of the quarter to give the employer sufficient time to gather the necessary funds to make the tax deposit and to have sufficient time to notify its payroll service, if there is one, to ensure a timely tax deposit.

- (9) In general, no sooner than thirty days after sending Letter 4520-P to the employer, the IRS will send Letter 4520, Section 3121(q) Notice and Demand. This letter will explain how the employer should report the IRC 3121(q) FICA tax liability to avoid penalties and interest.
- (10) There are two attachments to Letter 4520 based on Forms 4137:
- a. **Tax calculation worksheet:** Summarizes the IRC 3121(q) FICA tax liability, and
 - b. **Form 4137 detail spreadsheet:** Lists information from each Form 4137 filed under the employer's EIN (employer identification number).
- (11) The employer must report the IRC 3121(q) FICA tax liability on the Form 941 for the quarter corresponding to the date of the Section 3121(q) Notice and Demand. This Form 941 is referred to as the "reporting Form 941." The date of the Section 3121(q) Notice and Demand will be the last business day of the quarter in which the Letter 4520 is issued, not the mailing date of the letter.

- (12) If the employer fails to report the IRC 3121(q) FICA tax liability on the reporting Form 941, that quarter will be opened for a limited scope examination initiated on the missing IRC 3121(q) FICA tax liability. This limited scope exam will address the non-reporting of the IRC 3121(q) FICA tax liability **only**. The exam group should use the following codes to establish these limited scope exams on AIMS:

- **Project Code 1118:** Limited Scope Exam – Unreported IRC 3121(q) Tax
- **Tracking Code 7887:** 4137 Leads

Note: For more information on this Program, contact an NTRCP Analyst.

4.23.7.5 (12-18-2012) Information Return Reporting

- (1) Information reporting is a key component in IRS compliance programs. Information reporting also serves to further several key initiatives in the administration of federal income taxes, such as reducing burdens associated with tax return preparation.
- (2) IRC 6041 through IRC 6053 and Title 31 of the United States Code require that taxpayers report various types of payments to both the IRS and the recipients of the payments. These payments include such items as rent, salaries, wages and income paid in the course of a trade or business, and payments such as dividends, interest, and royalties made to another person.
- a. The term “information return” means any statement, return, form or schedule as described in Treas. Reg. 301.6721-1(g). See IRM 4.10.5.6, Information Returns, for details on information returns.
 - b. For large food or beverage establishments, a key information return for tip examinations is Form 8027, Employer’s Annual Information Return of Tip Income and Allocated Tips, discussed in IRM 4.23.7.5.1.
 - c. Employers who file Form 8027 and meet the tip allocation rules must report the allocated tip amounts on the affected tipped employee’s Form W-2, Box 8, for the applicable tax year.

4.23.7.5.1 (12-18-2012) Form 8027 Requirements

- (1) Treas. Reg. 31.6053–3 requires certain large food or beverage establishments to make an information return with respect to tips. The employer is required to file a separate information return for each calendar year in which the employer has employees. The information return will contain the following:
- a. The employer’s name, address, and employer identification number
 - b. The establishment’s name, address, and identification number
 - c. The aggregate gross receipts (other than nonallocable receipts) of the establishment from the provision of food or beverages
 - d. The aggregate charge receipts (charge receipts with charged tips)
 - e. The aggregate of charged tips on those charge receipts
 - f. The aggregate of tips reported to the employer by the tipped employees
 - g. The aggregate amount the employer is required to report under IRC 6051 with respect to service charges of less than ten percent
- (2) Large food or beverage establishments use Form 8027, Employer’s Annual Information Return of Tip Income and Allocated Tips, to make annual reports to the IRS on its food or beverage operations receipts and employees’ reported tips.
- (3) A “large food or beverage operation” is defined as one which normally employs more than ten employees on a typical business day during the preceding

calendar year and is an operation in which the tipping of food or beverage employees is customary. See Treas. Reg. 31.6053-3(j)(7).

- (4) The phrase “more than ten employees on a typical business day” is defined in Treas. Reg. 31.6053-3(j)(9). This test is met if one-half of the sum of the average number of employee hours worked per business day during the calendar month in which the aggregate gross receipts from food or beverage operations were the greatest, plus the average number of employee hours worked per business day during the calendar month in which the aggregate gross receipts from food or beverage operations were the least, is greater than 80 hours. This test includes all employees of a food or beverage operation not only food or beverage employees.

Note: Refer to “Worksheet for Determining Whether To File Form 8027” in the Instructions for Form 8027, for additional information.

- (5) A food or beverage employee is an employee who provides services in connection with the provision of food or beverages. Such employees include, but are not limited to; waiters, waitresses, busboys, bartenders, hostesses, maitre d's, dining room captains, wine stewards, cooks, and kitchen help. See Treas. Reg. 31.6053-3(j)(10). Employees who are not food or beverage employees include managers, coat check staff, doormen, and parking attendants.
- (6) A separate Form 8027 must be filed for each location under common ownership or control. If the total hours of all locations exceed the 80 hours computation, then each location must file a separate Form 8027. This is true even if the individual locations, when considered separately, would not exceed the 80 hours test.
- (7) For information about the requirement to file Forms 8027, see Instructions for Form 8027, Employer's Annual Information Return of Tip Income and Allocated Tips and Pub 1239, Specifications for Electronic Filing Form 8027, Employer's Annual Information Return of Tip Income and Allocated Tips.

4.23.7.5.2 (01-13-2014)

Form 8027 Allocated Tips

- (1) An employer who operates a large food or beverage establishment is required to allocate among tipped employees an amount equal to the excess of eight percent of the gross receipts of such establishment for the payroll period over the aggregate amount of tips reported by employees at such establishment to the employer. See Treas. Reg. 31.6053-3(d).
- (2) This results in an allocation of a percentage of gross receipts to tipped employees. The individual allocation is entered as an information item on the employee's Form W-2, Wage and Tax Statement, Box 8. There are no taxes withheld from allocated tips because they were not reported by the employee to the employer in a written statement. Employees must report the allocated tips from their Form(s) W-2, Box 8, on a Form 4137, Social Security and Medicare Tax on Unreported Tip Income, which must be attached to their Form(s) 1040 unless they can establish with adequate records that they received a lesser amount. Employees use Form 4137 to compute their share of social security and Medicare tax on these unreported tips. Employees use Form 8959, Additional Medicare Tax, to compute Additional Medicare Tax on these unreported tips. Form 4137 and Form 8959 are filed with Form 1040.
- (3) The employer is not required to report its share of social security and Medicare taxes on allocated tips because these tips were not reported in a written

statement by the employees receiving the allocated tip amounts. However, if unreported tips are determined in the course of a tip audit or through the Form 4137 Compliance Program, the employer is liable for its share of social security and Medicare taxes on the tips that were not reported by employees when notified by the IRS .

Note: Additional Medicare Tax is only imposed on the employee. There is no employer share of Additional Medicare Tax.

- (4) Examiners should consider whether to assert any penalties for an employer's failure to file Form 8027 and/or failure to report tip information on Form W-2 as required. See IRM 20.1.7, Information Return Penalties.

4.23.7.6
(12-18-2012)
**Other Information
Reporting Issues to
Review**

- (1) In the area of tip income reporting, employers and business owners at times mis-characterize certain payments. Examiners need to be alert for situations where payments for services are inappropriately structured or incorrectly classified. Mis-classification of payments may result in incorrect information return reporting and/or underpayment of employment taxes.

4.23.7.6.1
(12-18-2012)
**Payments to Drivers of
Taxicabs, Limousines,
Tour Buses, and Other
Modes of Transportation
for Services**

- (1) Certain payments to drivers of taxicabs, limousines, tour buses, and other modes of transportation may have been mis-characterized by employees, employers, or business owners as tips.
- (2) This may occur in situations that involve drivers who are employees of companies engaged in the business of transporting passengers for a fare (e.g., limousines and taxicabs). The drivers pick up and transport passengers to their requested destinations. Typically, the driver collects the fares from the passenger. It is customary for the passenger to tip the driver an amount in addition to the fare for the transportation provided. At issue are other payments the driver may receive in addition to the tips from the passenger.
- (3) Some business establishments such as adult entertainment clubs, restaurants, nightclubs, and other service establishments have a practice of making payments to drivers who bring passengers to their establishments.
 - a. Generally, the service establishment's personnel will not render payment to the driver until the passenger first pays a cover charge or otherwise indicates in some manner that they are patrons of the service establishment.
 - b. Payments by establishments to drivers are usually made in cash, although some establishments issue vouchers to the drivers that can be exchanged for cash at a later time.
 - c. The amount of the cash or voucher payment may or may not bear any relationship to the transportation fare, may vary depending upon the number of patrons, and may be far greater than either the fare or the customary tip for the transportation.
 - d. In many situations, one or more passengers are transported from a location such as a hotel directly to the establishment. In some cases, the driver may make agreements with certain hotel personnel so that when a guest wants to go to an establishment (e.g., hotel guest informs hotel personnel that they are interested in finding an adult entertainment club), the hotel personnel will summon the driver with whom they have an agreement from the hotel's transportation queue and the driver will split the payment from the establishment with the hotel personnel.

- e. In some cases, the passenger may not request a particular destination and the driver or hotel personnel will recommend an establishment that will pay the highest amount for delivering the passenger/patron.
 - f. Many establishments advertise in local magazines, specifically targeted at drivers in the transportation industry. The ads indicate that the establishment will pay a “referral fee,” “tip,” or “incentive” for delivery of passengers/patrons.
- (4) Generally, the drivers do not report the payments to their employer as tips. Thus, the employers are not treating the payments as wages subject to employment taxes. The absence of reporting on either Forms 1099 or Forms W-2 may result in some drivers not reporting the payments as income on their income tax returns.
- (5) Chief Counsel Advisory (IRS CCA 201106010, dated 12-01-2010), provides that under the facts and circumstances described in the CCA (similar to the situations described above), the payments from the establishments to the drivers are not tips received in the course of employment with the transportation company, but are considered payments for services separate and distinct from those the drivers perform for their transportation company employer. In addition, if the payments to one driver equal or exceed \$600 in a calendar year, the business making the payment is required to report these payments on Forms 1099.
- (6) When examining service businesses (such as restaurants, night clubs et al.), examiners need to investigate the existence of payments of this type which are usually paid in cash or by a voucher that can be converted to cash at a later date. Various techniques may be used to identify the existence of and deduction for such payments (including observation of drop-off locations of transportation companies at the establishment and inquiries regarding the establishment’s business deductions.)
- (7) The reporting requirements applicable to the payments made by the establishments described above are provided in IRC 6041(a). This section requires all persons engaged in a trade or business and making payment in the course of such trade or business to another person of rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other **fixed or determinable** gains, profits, and income of \$600 or more in any taxable year, to file an information return with the IRS and to furnish an information statement to the payee. Payments are fixed when they are paid in amounts definitely predetermined. Income is determinable whenever there is a basis of calculation by which the amount to be paid may be ascertained. Treas. Reg. 1.6041-1(c). Payments that are **fixed or determinable** must be reported on Form 1099. See Treas. Reg. 1.6041-1(a)(2).
- (8) If the payments at issue are for the separate and distinct services of delivering patrons, the service establishments are required under IRC 6041 to file a Form 1099 with the IRS for each person (driver) to whom they paid \$600 or more during the calendar year. If the establishments do not file Form 1099, examiners should consider assertion of penalties under IRC 6721 and IRC 6722. Penalty assertion should be discussed with the examiner’s manager.
- (9) Backup withholding should also be considered if the payor fails to secure a Taxpayer Identification Number (TIN) from the service provider individual (in this case, the driver). The payor is required to back-up withhold a percentage on the payment amount (24 percent). If the payor fails to withhold the current

applicable backup withholding percentage from the service provider, the payor becomes liable for the backup withholding under IRC 3406. See IRM 4.23.8.13, IRC 3406 - Backup Withholding.

- (10) Pub 4904, How to Report Driver Referral Fees, Incentive Payments, and Other Income You Receive, can be used to educate business owners of their reporting, filing, and payment obligations on payments for services.

4.23.7.6.2 (01-13-2014)

Tips vs. Service Charges

- (1) Tips are not defined in any IRS code section or regulation. Rev. Rul. 2012-18, 2012-26 I.R.B. 1032, provides criteria for determining whether a payment is a tip or a service charge. Service charges are frequently referred to as “auto-gratuities” in the hospitality industry. Rev. Rul. 2012-18 uses the criteria provided in Rev. Rul. 59-252, 1959 C.B. 215. We rely on Rev. Rul. 2012-18 in making the distinction between a tip and a service charge (or auto-gratuity). Examiners should verify that distributed service charges are properly characterized as wages subject to withholding, and not as tips.
- (2) Rev. Rul. 2012-18 provides specific examples of amounts characterized as tips and service charges to illustrate the application of factors relevant to distinguishing a tip vs. a service charge. Example A in QandA 1 of Rev. Rul. 2012-18 illustrates a service charge paid by a large party when the menu specifies that a fixed charge will be added to all bills for parties of 6 or more customers. Example B illustrates a tip in a situation where the credit card charge receipt shows sample tip calculations.
- (3) The incorrect characterization impacts the withholding rules and affects a number of forms and credits:
 - Form 8027, Employer’s Annual Information Return of Tip Income and Allocated Tips,
 - Form 8846, Credit for Employer Social Security and Medicare Taxes Paid on Certain Employee Tips, for the IRC 45B credit, and
 - Form 3800, General Business Credit.
- (4) The criteria of Rev. Rul. 2012-18 should be applied to determine whether the payment made is a tip or a service charge. Q&A 1 of Rev. Rul. 2012-18 provides that 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:
 - a. The payment must be made free from compulsion,
 - b. The customer must have the unrestricted right to determine the amount,
 - c. The payment should not be the subject of negotiation or dictated by employer policy, and
 - d. Generally, the customer has the right to determine who receives the payment.
- (5) A contractually fixed gratuity for catering, banquets, weddings, transportation, baggage handling and other events or items is generally considered to be service charges if the amount is distributed or paid to the service staff. A non-contractually fixed gratuity, or “auto-gratuity,” that is the policy of the employer is generally considered to be a service charge. If these amounts are distributed or paid to the employees, then the amounts are non-tip wages subject to withholding. Examples of employer policy driven service charges:

- a. Employer sets a fixed charge or “auto-gratuity” for all purchases in the food or beverage establishment regardless of amount of sale or number of guests
 - b. Auto gratuity added for a large party of customers
 - c. Bottle service fees or cork fees in night clubs or restaurants
 - d. Delivery fees in the pizza industry or other delivery service industries
- (6) Examinations performed in industries where tipping is customary should include the following:
 - a. An evaluation of the employer’s policy for customer gratuities,
 - b. The internal controls for payments received by the establishment or the employee as gratuities,
 - c. The splitting or pooling of gratuities,
 - d. The employee’s reporting of gratuities to the employer under IRC 6053(a), and
 - e. The distribution of gratuities from the employer to the employees.
- (7) The employer’s characterization of a payment as a “tip” is not determinative. The fact that the employee may have reported the payment as a “tip” to the employer is also not determinative. When performing a tip examination, examiners must ensure that distributed service charges are properly characterized as wages subject to withholding and not as tips. Distributed service charges that have been characterized as tips should generally be re-characterized and an adjustment made to the Form 941 under examination and reported on employment tax report Form 4666, Summary of Employment Tax Examination, and Form 4668, Employment Tax Examination Changes Report.
- (8) Amounts determined to be service charges and not tips are not eligible for the IRC 45B credit claimed on Form 8846, (and thus are not eligible for the General Business Credit claimed on Form 3800.)
- (9) When calculating the amount of unreported tips for an employer-only assessment under IRC 3121(q), examiners must ensure they do not include service charges in the Section 3121(q) Notice and Demand.
- (10) A review of the correct characterization of service charges does not constitute a “tip examination” within the meaning of a voluntary tip agreement. Establishments possessing a tip agreement can be contacted to review the tip vs. service charge issue. The examiner must take caution against making an adjustment for unreported tips and focus on the correct characterization and reporting of service charges.
- (11) A tip rate review of an employer participating in a voluntary tip compliance agreement should also include an evaluation of the items in the preceding paragraph.
 - a. Service charges should not be included in any calculation that arrives at an hourly tip rate, tip rate calculated on a percentage of sales, or any other rate determination method when preparing a voluntary tip compliance agreement.
 - b. Examiners should note in their work papers and appendices that service charges were not included in the tip rate computations.
 - c. The tip agreement should also instruct the employer how to account for and report service charges.

4.23.7.6.3
(01-13-2014)
**Prospective Treatment
of Revenue Ruling
2012-18, Tips vs. Service
Charges**

- (1) The IRS issued Rev. Rul. 2012-18 to clarify and update guidelines first presented in Rev. Rul. 95-7, 1995-1 C.B. 185, concerning the taxes imposed on tips under the Federal Insurance Contributions Act (FICA) and the notice and demand under section 3121(q) of the Internal Revenue Code (Code). In addition, communications with external stakeholders, examinations of tipped employers, and an increase in the use of “auto-gratuities” by employers that operate in service industries led the IRS to believe additional clarification in this area would be in the best interest of tax administration.
- (2) When Rev. Rul. 2012-18 was issued, the IRS also recognized that employers and employees would need some time to adjust their policies and accounting systems to fully comply with the guidance. The IRS therefore issued Announcement 2012-25 to alert employers of the examination policies communicated to IRS compliance personnel. That announcement contained the full text of an Interim Guidance Memorandum (IGM) issued to compliance personnel instructing examiners to apply the guidance of Rev. Rul. 2012-18 prospectively, under very limited facts and circumstances. As was communicated in Announcement 2012-25, examiners, in limited circumstances, may apply the guidance prospectively to amounts paid on or after January 1, 2013. The limited circumstances communicated in the IGM are:
 - a. In determining whether Q&A 1 of this Revenue Ruling should be applied prospectively, examiners should consider whether the set of facts and circumstances at issue was directly addressed in prior guidance and whether the business needs additional time to amend its business practices and make system changes to come into compliance.
 - b. Some of the prior guidance which may be applicable includes:

Ruling	Explanation
Rev. Rul. 57-397, 1957-2 C.B. 628	Where amounts required to be paid to a hotel by customers for using dining facilities included amounts distributed by the hotel to waiters and other employees.
Rev. Rul. 59-252, 1959-2 C.B. 215	Where negotiations between a hotel and customer for use of hotel’s banquet facilities included additional amounts for distribution to employees.
Rev. Rul. 64-40, 1964-1 C.B. 68	Where a club’s board of governors determined amounts distributed to employees from a fund made up of contributions by club members.
Rev. Rul. 64-74, 1966-1 C.B. 229	Where amounts collected by a club through mandatory charges added to members’ bills were distributed to employees.
Rev. Rul. 69-28, 1969-1 C.B. 270	Where five examples of amounts paid to employees are discussed.

- (3) If examiners find that the set of facts and circumstances at issue was not directly addressed in prior guidance, then Q&A 1 of Rev. Rul. 2012-18 should be applied prospectively. In this regard, Q&A 1 should be applied prospectively to amounts paid under facts that are substantially the same as Example A.
- (4) In general, if the very limited circumstances criteria is met, examiners should re-characterize the tips as service charges and make the appropriate examination adjustments per above.
- (5) In general, if the very limited circumstances criteria are not met, examiners should not re-characterize the tips as service charges, but still must ensure the service charges were reported to the employer and to the IRS as tips. If the service charges were not reported as tips examiners should consider issuing a Section 3121(q) Notice and Demand. Section 3121(q) Notice and Demand is discussed in IRM 4.23.7.7.4, Section 3121(q) Notice and Demand Procedures
- (6) In Announcement 2012-50, the IRS extended the prospective treatment, under the same very limited circumstances, to amounts paid on or after January 1, 2014. This gave employers an additional year to ensure their policies and accounting systems were in compliance with the guidance issued in Rev. Rul. 2012-18.
- (7) Employers that correctly treated service charges as wages are not entitled to a refund of any taxes they may have paid or will pay due to their proper reporting of service charges as wages.

4.23.7.7

(05-10-2021)

Employment Tax Tip Examination

- (1) Employment tax tip examinations are regular employment tax cases with tipping identified as a potential issue. Items to consider:
 - a. Review of Form 941 shows low or zero tips but the NAICS code indicates an industry where tipping is customary.
 - b. The amount of tips is low compared to the tip related sales.
- (2) Form 8027 is analyzed and compared to Forms 941 filed by employers to determine the potential for under-reported tips in the food and beverage industry. Factors to consider in a tip examination include if the Form 8027 indicates:
 - Charged tips are greater than or equal to total tips reported,
 - A significant disparity between the charge tip rate and the cash tip rate, and
 - Allocated tips at a rate lower than 8 percent and there is no tip rate reduction determination letter for the taxpayer.

See IRM 4.23.7.12, Petition for Lower Rate.

- (3) Examiners may be assigned a case where the taxpayer is under a voluntary tip compliance agreement described in IRM 4.23.7.10, Tip Rate Determination and Education Program (TRD/EP). There may be historical information contained in the case file pertaining to the type of tip agreement and any compliance activity the IRS has employed to improve compliance by the taxpayer. Compliance reviews are not tip examinations and are conducted differently than a case selected for a tip examination. If you receive a case for a compliance review, contact the NTRCP Policy Analyst for details on these procedures.

- (4) The terms of the tip agreement generally provide that the IRS will not examine employers under a tip agreement as long as the employer is complying with the terms of the agreement. If a tip examination has been opened in error and the examiner has not reviewed books and records, the examination should be closed using Disposal Code "32," Survey After Assignment. If books and records were reviewed, the examination should be closed using Disposal Code "02," No-Change. If the examiner's manager believes there has been egregious noncompliance or an abusive situation exists, he or she should contact the SB/SE National Tip Reporting Compliance Program Manager to discuss alternatives and future actions.
- (5) During the initial interview, examiners should clarify with the taxpayer that this is not an income tax examination - it is an employment tax examination. Examiners should explain that they will be gathering information to determine the correct tip income earned by the establishment's employees.
- (6) Examiners must consider expanding the scope of a tip audit when warranted. Tip audits are not limited in scope to tip related issues and examiners are responsible for ensuring the full compliance of the taxpayer under examination.
- (7) Per IRM 4.23.7.7.1(2), Report Writing for Tip Examinations, cases classified for a **tip examination** should not be limited in scope to tip related issues. Examiners must perform the required filing checks to ensure the taxpayer is in compliance with other filing, payment and reporting obligations. Other common issues, such as fringe benefits and unreported or underreported compensation, should be considered and added to the tip audit examination plan when appropriate.
- (8) To complete the required filing checks, examiners must conduct an analysis of all subsequent returns which are filed or due before the audit is closed and all prior returns which have open statutes, including those not filed. This analysis includes evaluating audit potential through IDRS research to determine whether:
 - a. The taxpayer met their filing, payment and reporting obligations;
 - b. Liens or bankruptcy indicators are present;
 - c. Tip noncompliance identified on the return under audit is likely to be present on the prior and/or subsequent return(s) and if such noncompliance is material; and
 - d. Collectability is a factor.
- (9) If need to complete the required filing checks, examiners should inspect taxpayer's retained copies or requisition the original returns.
- (10) If the required filing checks result in a determination that the taxpayer is not in compliance with income tax filing requirements, the examiner must complete Form 5346, Examination Information Report, and forward it to the SB/SE Employment Tax Workload Selection and Delivery (ET WSD) (per IRM 4.23.3.3.6.1, SBSE ET-WSD Referrals).
- (11) Audit steps and findings must be documented in the audit workpapers.

4.23.7.7.1
(05-10-2021)
**Scope of Tip
Examination**

- (1) Cases classified for a “tip examination” should not be limited in scope to tip related issues only. Examiners should perform the required filing checks to ensure the taxpayer is in compliance with other filing, payment, and reporting obligations. Other common issues such as fringe benefits and unreported or underreported compensation should be considered and added to the examination plan when appropriate.
- (2) Examiners should conduct the examination to a point where the reported employment tax liability is determined to be substantially correct. Examiners must determine whether information returns such as wage and tax statements have been correctly filed and whether all applicable Federal return requirements have been met. See IRM 4.23.3.6.3.2, Scope of Employment Tax Examination, for further details.

4.23.7.7.2
(05-10-2021)
**Employer Tip
Examinations**

- (1) On June 17, 2002, the Supreme Court rendered a decision in favor of the IRS, in *U.S. v. Fior d'Italia, Inc.*, The Court determined that the IRS has the authority to assess the employer’s share of social security and Medicare taxes due on employees’ tip income using an aggregate estimation method. In light of this case, the IRS may generally conduct tip examinations and make assessments for social security and Medicare taxes on employers only, without first examining the tip records of the individual employees.
- (2) As it is critical that examiners meet with the employer to arrive at the correct tip income and to determine the factors affecting how this income is to be reported on the employer’s tax returns, the examiner should contact the employer to schedule an appointment. This is generally done by mailing Letter 3850, Employment Tax Appointment Letter, or Letter 3851, Employment Tax Call-in Appointment Letter. The examiner must enclose an Information Document Request (IDR) with the examiner’s confirmation/appointment letters. The IDR should be tailored for the particular taxpayer and should be separated by topic and recipient.
- (3) Examiners should establish on AIMS all periods for which books and records are examined, generally all four quarters in a tax year. To ensure proper tracking of audit results, use Project Code “0673” and Activity Code “465” when establishing the employer’s returns on AIMS. Refer to the most recent Project/Tracking Code list from Employment Tax Policy to confirm that the appropriate tracking code is used to identify the examination.
- (4) When tip income is an issue, the examiner should determine whether employees are reporting tips to their employer and if the employer is withholding employment taxes as required. The examiner should determine if the amount of tip income reported is reasonably correct. At a minimum, the examiner should consider the following:
 - a. **Nature of the establishment.** Employees of fine dining restaurants generally receive more tips than those of less expensive restaurants since tips are generally a percentage of the customer’s bill. The same would apply to tips paid to employees of expensive hotels, beauty shops, etc.
 - b. **Method of payment.** Does the establishment accept cash, checks, credit cards, debit cards, or charge accounts? Are all types of payment reported as tip income by the employee?
 - c. **Geographical location of the establishment.** Different areas have varying tipping habits.

- (5) When the examiner determines it is necessary to pursue the unreported tip income issue, the “McQuatters Formula” provides a method of reconstructing tip income that has been accepted by the courts. It specifically addresses factors to be considered in determining a tip rate and the types of items used for making a reduction, such as tip outs and stiff rates. See *McQuatters v. Commissioner*, T.C. Memo, 1973–240. In *McQuatters*, the stiff rate (term used when a customer does not tip the server) was applied to the gross sales. With the increased use of credit cards and debit cards, the volume of charge sales that include a tip have also increased. Therefore, applying a stiff factor to gross sales would not be appropriate. In tip examinations, the examiner should apply the stiff rate only to cash sales and charge sales that did not have a tip added to the bill. The stiff factor should not be applied to charge sales including a tip amount. To obtain an electronic version of the calculation worksheet to use, contact an analyst with NTRCP. However, where the “McQuatters Formula” cannot be applied, the examiner may use any method deemed reasonable to arrive at the correct income. See IRC 446(b).

Note: Treas. Regs. 31.6053-3(j) provides that gross receipts include the retail value of certain complimentary food or beverages. See Treas. Regs. 31.6053-3(j)(16).

- (6) In general, for tip examinations, examiners should consider expanding the examination to include the prior and subsequent tax periods.
- (7) If the employer is participating in a tip agreement described in IRM 4.23.7.10 and is complying with the commitments under this agreement, then any social security and Medicare tax assessments made against the employer must mirror those first made from additional tips self-reported by an employee (i.e., Form 4137) or assessed through an audit. Form 14439 is for collecting the tipped employee information (for both tip examinations and reporting agreement non-participants). Information on audited individual tipped employees come from other exam areas of the IRS, such as Campus Audit. As a general rule, Employment Tax Specialists do not perform the tipped employee Form 1040 examinations. The information gathered from the Form 14439 of the examined employees is used to determine the employer’s social security and Medicare tax assessment. The examination must be in Status 90 prior to sending the NTRCP Analyst a copy of the Form 14439. However, if the employer is not in compliance with the commitments under the agreement, then tax assessments may be made against the employer without first examining the tip records of the individual employees, but only if the tip agreement has first been terminated.

Note: Before an examiner can initiate an employer-only examination of an employer who is a party to a tip agreement described in IRM 4.23.7.10, the agreement must be terminated. Documentation and other evidence in the case file must establish that the employer failed to comply with the terms of the agreement before the IRS can terminate or revoke the agreement. Refer to the Delegation Order 4-34 for GITCAs and Delegation Order 1.23-20 for TRACs and TRDAs for current revocation signatory approvals.

- (8) If the tip examination case resulted from a classification activity, and is a large food or beverage establishment, the case file should contain a simulated Form 8027 for each establishment under the employer’s EIN and an IRC 3121(q) Pre-Audit FICA Tax Calculation Worksheet that will provide the examiner with an estimate of the potential IRC 3121(q) liability. It is the examiner’s responsi-

bility to review this information and validate the amounts shown on the Form 8027 using the employer's books and records. The examiner will then prepare an Examination IRC 3121(q) FICA Tax Calculation Worksheet that will be included with the Section 3121(q) Pre-Notice and Notice and Demand letters sent to the employer.

- (9) NTRCP has developed worksheets to assist the examiner in arriving at the correct unreported tip amount and correct tax liability. This worksheet is attached to Letter 3264, Pre-notice for Employer Share of Tax due on Unreported Tips, as well as the Section 3121(q) Notice and Demand, Letter 3263-E, Notice and Demand - Employer Only, or Letter 3263, Section 3121(q) Notice and Demand.
- (10) The worksheets accommodate tip computations that may not have been based on the "McQuatters Formula" (e.g., Tip per Product) and also allow the examiner to consolidate tip computations from multiple venues or establishments. The worksheet is available in two versions:
 1. Single establishment, and
 2. Multiple establishments or venues.

The computations on both worksheets are identical, however the multiple establishments/venue worksheets provide a section for listing the individual amounts of underreported tips by establishment/venue. Instructions for completing the worksheet are built into the electronic file. Contact an NTRCP Analyst for electronic copies of these worksheets.

4.23.7.7.3
(05-10-2021)
**Report Writing
Procedures for Tip
Examinations**

- (1) There are unique report writing procedures for employment tax examinations where underreported tip income earned by employees is an issue. These examinations are often referred to as IRC 3121(q) cases. These procedures ensure that tip examinations meet the quality standards and conform to general employment tax report writing procedures. See Exhibit 4.23.7-2, Chart of Tip Report Writing Instructions, for a summary of scenarios.
- (2) The examination of tip related and other employment tax issues involves inspection of an employer's book and records. The examiner must issue an examination report or no-change letter at the conclusion of each examination. An employment tax liability resulting from a tip examination is considered a current period liability when the notice and demand is issued to the taxpayer. Taxpayer liabilities generated under the authority of IRC 3121(q) require slight deviations from the common report writing procedures.
- (3) At the conclusion of an employment tax examination, the examiner will issue Form 4666, Summary of Employment Tax Examination, to the taxpayer. The Form 4666 should address all examined issues, regardless of determination.
- (4) In addition to report Form 4666, the examiner may need to issue Letter 4840, Unreported Tips and No Change for Other Examined Issues. Letter 4840 is used when, in addition to the issue of unreported tips, other employment tax issues were examined, resulting in an adjustment to employment tax due to unreported tips; but no adjustment made to the other examined employment tax issues. In addition, Letter 4840 lets the taxpayer know that while there was no adjustment made to taxes for the year of examination, there is a liability due on the unreported tips to be reported as a current period liability. The letter explains when and how the IRC 3121(q) FICA tax liability must be reported.

- (5) If the only issue examined is unreported tips and no adjustment is warranted, the examiner issues Form 4666 and Letter 3401-A, Employment Tax No Change Transmittal Letter. Under these circumstances, no specialized report writing procedures are required. The examiner would follow normal employment tax report writing procedures as discussed under IRM 4.23.10.5, Notification Letters in No-Change or No-Liability Cases. The examiner will prepare the final no-change letter, Letter 3381, No Change Letter for Employment Taxes, in duplicate, and include in the case file for manager approval and issuance by Centralized Case Processing (CCP).
- (6) If the only issue examined is unreported tips and an adjustment to unreported tips **is** warranted, the examiner will prepare Form 4666 and Letter 3264, Pre-notice for Employer Share of Tax due on Unreported Tips, to be included with the examination report package issued to the taxpayer. The examiner will not enter any dollar amount on Form 4666 under column c. This is because the IRC 3121(q) FICA tax liability owed by the taxpayer is reported on the current Form 941 for the quarter corresponding to the date of the Section 3121(q) Notice and Demand. Letter 3264 gives the taxpayer a brief overview of the process for reporting the IRC 3121(q) FICA tax liability and will include a detailed calculation of the additional taxes that will be shown on the Section 3121(q) Notice and Demand. Form 4666 should include the following when the only issue examined was unreported tips and the taxpayer owes additional tax on these unreported tips:

Example: IRC 3121(q): “The inspection of your books and records resulted in the determination that your employees did not report all of the tips they earned to you, their employer. You owe additional tax on these unreported tips. Once the IRS issues you a Section 3121(q) Notice and Demand for the social security and Medicare tax due on the unreported tips, you will become liable for the employer’s share of the tax under Internal Revenue Code section 3121(q) (IRC 3121(q)). The Section 3121(q) Notice and Demand for this tax will be sent to you no sooner than 30 days from the date of this letter, showing tax due of \$_____ on unreported tips of \$_____ for the tax year(s) shown above. This letter will provide detailed instructions on how to report and pay this tax. Enclosed with this report you will find Letter 3264, a pre-notice to the Section 3121(q) Notice and Demand. This pre-notice is to give you time to gather the necessary funds and deposit the tax timely, to avoid any possible interest or deposit penalties. Future correspondence will provide you guidance on how to properly report and pay the tax to avoid any interest or penalties.”

Note: The IRC 3121(q) FICA tax liability is treated as a current tax liability and will be assessed when reported on a current period Form 941 through the Section 3121(q) Notice and Demand process. The examiner should not place these adjustments on Form 4668, Employment Tax Examination Changes Report. There is no Form 4668 report prepared for examinations limited in scope to unreported tips since the change in tax is a current period liability.

- (7) If there is a determination that all tips were correctly reported but adjustments are warranted to other employment tax issues identified during the course of the examination, the examiner will issue Form 4666 and follow the employment tax report writing and closing procedures in IRM 4.23.10, Report Writing Guide

for Employment Tax Examinations. Under these circumstances, no specialized tip report writing procedures are required.

- (8) If other employment tax issues in addition to tips were examined but adjustments are warranted only to unreported tips, the examiner should issue Form 4666 and Letter 4840, Unreported Tips and No Change for Other Examined Issues. When listing the examined issues on Form 4666, the examiner will not enter any dollar amount for the IRC 3121(q) tips issue. Form 4666 should include the language provided below. Letter 4840 informs the taxpayer that the only examined issue that warranted an adjustment was on the unreported tips. Letter 4840 also informs the taxpayer that Letter 3264, Pre-Notice for Employer Share of Tax due on Unreported Tips, is enclosed with the examination report package. Letter 3264 gives the taxpayer a brief overview of the process for reporting the additional tax and should include a detailed calculation of the additional taxes to be included in the Section 3121(q) Notice and Demand. Add the following language to Form 4666 when, in addition to unreported tips, other employment tax issues were examined but the only issue adjusted is unreported tips:

Example: IRC 3121(q): “The inspection of your books and records resulted in the determination that your employees did not report all of the tips they earned to you, their employer. You owe additional tax on these unreported tips. Once the IRS issues you a Section 3121(q) Notice and Demand for the social security and Medicare tax due on the unreported tips, you will become liable for the employer’s share of the tax under Internal Revenue Code section 3121(q) (IRC 3121(q)). The Section 3121(q) Notice and Demand for this tax will be sent to you no sooner than 30 days from the date of this letter, showing tax due of \$_____ on unreported tips of \$_____ for the tax year(s) shown above. This letter will provide detailed instructions on how to report and pay this tax. Enclosed with this report, you will find letter 3264, a pre-notice to the Section 3121(q) Notice and Demand. This pre-notice is to give you time to gather the necessary funds and deposit the tax timely, to avoid any possible interest or deposit penalties. Future correspondence will provide you guidance on how to properly report and pay the tax to avoid any interest or penalties.”

- (9) If the examination results in adjustments to other employment tax issues and adjustments to unreported tips, the examiner must prepare Form 4666 and Form 4668. When listing the examined issues on Form 4666, you will not enter any dollar amount for the IRC 3121(q) tips issue. Form 4666 should include the language provided below in the “Other Information” section. The examiner should also include Letter 3264, Pre-notice for Employer Share of Tax due on Unreported Tips. Form 4666 gives the taxpayer a brief overview of the process for reporting the additional tax and should include a detailed calculation of the additional taxes to be included in the Section 3121(q) Notice and Demand.

Note: IRC 3121(q): “In addition to the examination changes shown on Form 4668, we also examined tip income. The inspection of your books and records resulted in the determination that your employees did not report all of the tips they earned to you, their employer. You owe additional tax on these unreported tips. Once the IRS issues you a Section 3121(q) Notice and Demand for the social security and Medicare tax due on the unreported tips, you will become liable for the employer’s share of the tax under Internal Revenue Code section 3121(q) (IRC 3121(q)). The Section 3121(q) Notice and

Demand for this tax will be sent to you no sooner than 30 days from the date of this letter, showing tax due of \$_____ on unreported tips of \$_____ for the tax year(s) shown above. This letter will provide detailed instructions on how to report and pay this tax. Enclosed with this report, you will find Letter 3264, a pre-notice to the Section 3121(q) Notice and Demand. This pre-notice is to give you time to gather the necessary funds and deposit the tax timely, to avoid any possible interest or deposit penalties. Future correspondence will provide you guidance on how to properly report and pay the tax to avoid any interest or penalties.”

- (10) If the examination of the taxpayer’s books and records did not include the examination for employment tax purposes of whether any individuals should be treated as employees of the taxpayer for the purposes of Section 530 of the Revenue Act of 1978, as amended, a statement to that effect should be included on any Form 4666 and/or Form 4668 issued to the taxpayer. See IRM 4.23.10.10.3, Employment Tax No-Change Report.
- (11) Section 3121(q) Notice and Demand Procedures and Case Closing are discussed below in IRM 4.23.7.7.4, Section 3121(q) Notice and Demand Procedures.

4.23.7.7.4
(05-10-2021)
**Section 3121(q) Notice
and Demand Procedures**

- (1) When an employee fails to report tips to the employee’s employer, the employer is not liable for its share of the social security and Medicare taxes on the unreported tips until the IRS makes notice and demand to the employer. See IRC 3121(q).
- (2) The employer is liable for the employer’s share of social security and Medicare taxes for tips even though the employees failed to provide the employer with written statements. The additional tax liability may be based upon the employer’s records for the tax year and/or on Form 4137 filed by employees. The additional tax liability is not due until the IRS issues a Section 3121(q) Notice and Demand (even though the tips were paid to employees in prior years).
- (3) No specific form is required for a Section 3121(q) Notice and Demand, but the IRS has developed correspondence. The first letter to be issued is Letter 3264, Pre-notice for Employer Share of Tax due on Unreported Tips, which is sometimes referred to as a “pre-notice letter.”
- (4) Generally, the IRS will send the taxpayer the pre-notice Letter 3264 at least thirty days prior to issuing the Section 3121(q) Notice and Demand to allow the taxpayer sufficient time to gather the necessary funds for making a timely tax deposit. Examiners **must** use Letter 3264, to notify the taxpayer of the IRC 3121(q) FICA tax liability.
 - a. At the time the pre-notice is issued, the examiner should emphasize to the taxpayer that if a payroll service is used, the taxpayer should immediately notify the payroll service of the IRC 3121(q) FICA tax liability. This is to provide the payroll service provider sufficient time to make the necessary payroll deposit and to help reduce or eliminate any interest or deposit penalties.
 - b. It is recommended that examiners issue the Section 3121(q) Notice and Demand within the first 60 days of the quarter to give the taxpayer sufficient time to gather the necessary funds to make the tax deposit and to have sufficient time to notify its payroll service, if there is one, to ensure a timely tax deposit. If the employer reports the IRC 3121(q) FICA tax

liability on the line titled "Section 3121(q) Notice and Demand -- Tax due on unreported tips" on the Form 941 for the quarter corresponding to the date of the Section 3121(q) Notice and Demand and makes a timely deposit based on the date of the Section 3121(q) Notice and Demand, the tax due on this liability is interest and penalty free.

- (5) Generally, at least thirty days after the Pre-Notice letter is sent to the taxpayer, the IRS will send the Section 3121(q) Notice and Demand Letter 3263. This letter will explain how the employer should report and pay the IRC 3121(q) FICA tax liability to avoid penalties and interest.
 - a. The employer must report the IRC 3121(q) FICA tax liability on the Form 941 for the quarter corresponding to the date of the Section 3121(q) Notice and Demand. This Form 941 is referred to as the "reporting Form 941."
 - b. If the employer fails to report the IRC 3121(q) FICA tax liability on the reporting Form 941, the examiner will initiate an examination of the reporting Form 941 in order to assess the IRC 3121(q) FICA tax liability. This, in essence, constitutes an unagreed report and the examiner then adheres to normal unagreed procedures and reports. Rev. Rul. 2012-18, provides guidelines for IRC 3121 Notice and Demand procedures.
- (6) The examiner must post-date the Section 3121(q) Notice and Demand to account for mailing delays and to provide sufficient time following receipt to allow employers to adjust their deposit amounts accordingly. A Section 3121(q) Notice and Demand should not be issued or dated on a Saturday, Sunday, or federal holiday. Therefore, the date on the Section 3121(q) Notice and Demand should be post dated with the last day of the quarter.

Example: The examiner mails Letter 3263-E, Notice and Demand - Employer Only, to the taxpayer on February 24, 2020. The date of the Section 3121(q) Notice and Demand is March 31, 2020.

- (7) There are two Section 3121(q) Notice and Demand letters for use in employer tip examinations:
 - a. Letter 3263-E is used for employer-only examinations where the audit results are not dependent on any audits of the employer's tipped employees.
 - b. Letter 3263 is used for employer tip examinations where the employer has signed a tip compliance agreement. Any assessment against the employer must mirror that first made against the individually audited tipped employees.
- (8) For assessments based on the results of the employees' examinations, the examiner may disclose certain information on employee returns in the Section 3121(q) Notice and Demand issued to the employer. This information may be disclosed only if it is necessary to substantiate the employer's share of social security and Medicare taxes on the unreported tip income. The information may be disclosed because it "directly affects" or "directly relates to" the resolution of an issue and there is a transactional relationship between the employer and the employee. See IRC 6103(h)(4)(B) and IRC 6103(h)(4)(C).
- (9) When the employer's liability is dependent on the outcome of the tipped employees' audits, then the examiner should attach a spreadsheet (Form 14439) to the Section 3121(q) Notice and Demand explaining the tax liability.

The examiner may also attach this spreadsheet to the Pre-Notice and Demand. The Form 14439 should include information such as the following:

- a. Employee name, social security number, job position, dollar amount of sales or the number of hours worked
 - b. Tip rate used in the calculation
 - c. Tips reported by the employee
 - d. Unreported tips by the employee
- (10) For employer-only audits, there is no requirement to provide a breakdown of the audited employees' assessments. However, the examiner will attach the *McQuatters* calculations, or other calculation spreadsheet if *McQuatters* was not used, to the Section 3121(q) Notice and Demand to show how the liability (aggregate assessment) was determined. When examining a casino, the examiner will attach a spreadsheet showing the unreported tip amounts broken down by the tipped occupational categories.
- (11) After the examiner issues the Section 3121(q) Notice and Demand, all quarters examined are closed using Disposal Code "01", No-Change with Adjustment, unless other adjustments were made to the return. This disposal code should be used regardless of the agreement or lack of agreement by the taxpayer to the proposed IRC 3121(q) FICA tax liability.
- (12) The examiner can generally close the exam to the group manager 30 days after the Section 3121(q) Notice and Demand (Letter 3263-E or Letter 3263) was issued to the taxpayer. Once the examiner issues the Section 3121(q) Notice and Demand and the case is ready to be closed, the Form 5344, Examination Closing Record, is prepared. See IRM 4.23.7.7.3 for procedures when other employment tax issues warranted adjustments. If other employment tax issues are examined and an adjustment made, use the primary issue disposal code.
- (13) For each quarter examined, complete Form 5344, "Item 418 - 3121(q) Amount," to capture the IRC 3121(q) FICA tax liability. Generally, the IRC 3121(q) FICA tax liability should be spread among all the examined periods in a year in a ratable manner - thus, the amount to enter for each quarter is the social security and Medicare tax amount shown in the Section 3121(q) Notice and Demand divided by the number of quarters examined. For example, if the IRC 3121(q) FICA tax liability is \$4,000 and only one year was examined, you would enter \$1,000 for each of the four quarters examined for the tax year.
- On Form 5344, if case is closed agreed, enter on Line 12 Transaction Code "300" with "0" for the dollar amount.
 - "0" is entered because the additional tax is treated as a current period liability.
 - The Form 941 quarter to be established for the Unagreed Report is the quarter corresponding to the date of the Section 3121(q) Notice and Demand.
- Note:** The amount you enter on Line 418 is the IRC 3121(q) FICA tax liability, **NOT** the unreported tip amounts.
- (14) On the Form 3198 under "Letter Instructions for CCP," notate: "Please validate that the amount on Form 5344, Line 418, matches the amount on the enclosed Section 3121(q) Notice and Demand, Letter 3263."

- a. Attach a copy of the Section 3121(q) Notice and Demand (Letter 3263 or Letter 3263-E) to the inside of the folder (left side).
 - b. Retain a copy of the Section 3121(q) Notice and Demand and any work papers which support the computation attached to it. The retained copies of these items are needed if the employer fails to report the IRC 3121(q) FICA tax liability on the reporting Form 941 and an examination of the reporting Form 941 is required. The “reporting Form 941” is the Form 941 for the quarter in which the Section 3121(q) Notice and Demand was dated. The examination will be processed as an unagreed report
- (15) Each group must monitor the “reporting Form 941” and must maintain a spreadsheet containing details of monitoring activity and time spent monitoring the reporting Form 941. Make the information available to your manager as needed. Time spent monitoring the filing or assisting the taxpayer in the resolution of an incorrect or non-reporting of the IRC 3121(q) FICA tax liability is recorded under Activity Code 575-5XX, depending on the type of tipped industry being examined. For example, time spent monitoring a restaurant tip case would be recorded as 575-518. (For additional information on applicable time codes see Exhibits 1 and 2, Definitions of Miscellaneous Examination Activity Codes (Direct and Non-Direct), in IRM 4.9.1, Examination Technical Time Reporting System - Outline of System.)
- (16) After the reporting Form 941 has posted, generally within two to six weeks following the close of the quarter, the examiner must check IDRS/BRTVU to confirm that the employer properly reported the IRC 3121(q) FICA tax liability shown in the Section 3121(q) Notice and Demand.
 - a. For tax years after December 31, 2010, the IRC 3121(q) FICA tax liability is reported on the reporting Form 941, on the line titled “Section 3121(q) Notice and Demand—Tax due on unreported tips.”

Note: For Section 3121(q) Notice and Demands issued during tax years 2009 and 2010, this amount was reported on line 7c - “Current quarter’s adjustments for tips and group-term life insurance.” For Section 3121(q) Notice and Demands issued during tax years 2005, 2006, 2007, and 2008, the amount was reported on line 7e - “Prior quarter’s social security and Medicare taxes.”

 - b. If IDRS research shows that the amount was accurately reported, no further action is needed.
 - c. If the tax was not reported, the examiner will first contact the taxpayer to determine if the non-reporting was simply an oversight. The examiner should instruct the employer to file a Form 941-X for the quarter of the reporting Form 941 and pay the tax with the form. If the examiner is unable to resolve the reason for the non-reporting then he or she will establish the reporting Form 941 on AIMS. A limited scope exam, using Project Code “1118”, will be conducted to address the non-reporting of the IRC 3121(q) FICA tax liability. Follow normal employment tax unagreed procedures at IRM 4.23.10.16, Unagreed Employment Tax—Examination Reports.

Note: If an adjustment is made to the “reporting Form 941” for the IRC 3121(q) FICA tax liability, **DO NOT** enter any value on Item 418 of the Form 5344 when that case is closed.

4.23.7.7.5
(05-10-2021)
**Employee Tip
Examination**

- (1) If unreported tip income is identified as a result of an employer tip examination, then the employee and employer are liable for FICA tax on the unreported tip income. The employee is also liable for income tax on the unreported tip income.
- (2) Generally, examiners will collect employee information in the form of an “employee record layout spreadsheet”. The spreadsheet includes pertinent information regarding the employer’s tipped employees such as the total tips per examination and the potential unreported tips for each tipped employee. Check with the designated NTRCP Analyst to get an electronic copy of the latest version of the employee record layout spreadsheet. The examiner will forward this information and a copy of the McQuatters formula or other calculation showing how the tip rate was determined to the SBSE NTRCP Analyst who will complete the exam referral.
- (3) Indian Tribal Government (ITG) examiners are required to prepare an employee calculation spreadsheet for all tipped employees in each occupational category showing unreported tips. A copy of the spreadsheet should be sent to the ITG Tip Coordinator at the time the employer tip audit is closed.
- (4) If the examiner initiates the employee examinations, the employee returns will be established on AIMS . Use Activity Codes 530 through 536. To ensure proper tracking of audit results, use the following project codes:
 - 360: Gaming industry employees (all venues, including food and beverage)
 - 364: Food and beverage industry employees
 - 672: Barber and cosmetology industry employees
- (5) Generally, Employment Tax Specialists do not perform the tipped employee Form 1040 examinations. The employee’s tax adjustments are made on forms prescribed for individual income tax examinations. Procedures for adjustments to an employee’s tax for tips not reported to the employer are discussed in IRM 4.23.10.18, Procedures for Employee Tax Adjustment on Tip Income Not Reported to Employer.
- (6) Advance payments received for employment tax cases should be reported in accordance with the taxpayer’s instructions. Absent instructions, the payments will be reported first as if they were for income tax and the balance will be reported as social security and Medicare taxes.
- (7) If the case is unagreed, Letter 525, General 30-Day Letter, is issued for both the social security and Medicare taxes and income tax. Form 2504-S, Agreement to Assessment and Collection of Additional Tax and Acceptance of Overassessment (including section 530 statement), is generated along with the 30-day letter showing the separate computation for the social security and Medicare taxes due. The taxpayer is notified in the report that the social security and Medicare taxes are not included in the deficiency notice and are stated separately on Form 2504-S. If the employee requests an Appeals conference, the employee’s case should be forwarded to Appeals using normal procedures.
- (8) If the employee fails to respond to the 30-Day letter, the case should be closed for the issuance of a Statutory Notice of Deficiency on the income tax deficiency and related penalty only. Social security and Medicare taxes, unlike income tax, may be assessed without issuing a Statutory Notice of Deficiency.

If a Statutory Notice of Deficiency is to be issued for income tax, the social security and Medicare taxes on the unreported tip income and the related penalty will not be included in the audit report. However, the notice to the taxpayer will include a statement concerning the related social security and Medicare taxes and penalty liability.

- (9) Examiners must remember to properly code the tip audit adjustments on the Form 5344, Examination Closing Record, or Form 5599, TE/GE Examined Closing Record. The IRS submits this information electronically to the Social Security Administration. The codes can be found in the AIMS Processing Handbook, IRM 4.5.1, TE/GE AIMS Processing, Form 4137, Social Security and Medicare Tax on Unreported Tip Income, Adjustments. If these codes are not entered properly, the tipped employee's social security and Medicare wages will not show increase in wages due to the adjusted tip income and the employee will not receive social security credit.

4.23.7.8
(05-10-2021)

**Statute of Limitations for
Tip Examinations**

- (1) For employment tax audits where unreported tip income is the sole issue, it is not necessary to extend the statute date on the employer's Form 941 for the tax year under examination. The statute of limitations for the IRS to assess the employer's share of the social security and Medicare taxes on unreported tips is determined by the reporting Form 941 (i.e., the quarter corresponding to the date of the Section 3121(q) Notice and Demand). Accordingly, the examiner is permitted to conduct a tip examination for the employer's share of the FICA taxes on unreported tips even though the regular statute date could under normal procedures bar the examiner from working that tax period. If a case is assigned to an examiner where the statute date for the tax year under audit causes the system to generate Form 895, Notice of Statute Expiration, perform the following procedures:
 - a. Form 895 will be generated based on the month and year of the return's statute just as they do for all returns where the statute is irregular. This feature is an integral part of the statute control process.
 - b. The examiner will complete the Form 895 when the system generates it due to the irregular statute.
 - c. Examiners should follow the procedures in IRM 25.6.1, Statute of Limitations - Statue of Limitations Processes and Procedures. Although for an employment tax audit where unreported tip income is the only issue, the statute is governed by the date of the Section 3121(q) Notice and Demand, examiners still need to prepare the Form 895, Notice of Statute Expiration, within the specified time frame of 180 days.
 - d. Enter "MM/AD/YYYY" in Section 5.
 - e. In Section 6, place a checkmark on the line "Employment Tax Return Examination Limited to IRC 3121(q) (AD)."
 - f. In Section 7, enter as remarks "Statute for 3121(q) examination year is determined by the date of Section 3121(q) Notice and Demand."
- (2) Once the Section 3121(q) Notice and Demand is issued, the applicable period of limitations is the period of limitations for the employer's Form 941, Employer's QUARTERLY Federal Tax Return, for the calendar quarter in which notice and demand is made and NOT the period(s) of limitations for the returns for the quarters in which the tips were received. As a general rule, the IRS must assess the employer FICA taxes on the unreported tips within 3 years after April 15th of the calendar year following the year in which the notice and demand is made.

Example: If the Section 3121(q) Notice and Demand is dated December 31, 2020, the liability is required to be reported on Form 941 for the fourth quarter of 2020, due on January 31, 2021. If the employer timely files the Form 941, the period of limitations for assessment ends on April 15, 2024.

- (3) However, if the employer did not file its Form 941 for the fourth quarter of 2020 before April 15 of the succeeding calendar year (April 15, 2021) and instead filed on May 10, 2021, the IRS must assess the employer FICA taxes by May 10, 2024, the date three years after the date the return was filed.

Example: If the employer files a false or fraudulent Form 941 for the quarter in which the adjustment is required to be made or fails to file Form 941 for that quarter, the additional employer FICA taxes on the unreported tips can be assessed at any time.

- (4) If it is necessary to extend the statute, use Form SS-10, Consent to Extend the Time to Assess Employment Taxes, to extend the statute of limitations for assessing against the employer additional FICA tax on the unreported tip income. The IRS may assess the employer's share of FICA on the unreported tip income even if it is barred by the statute of limitations from assessing the employee's share of FICA tax.

4.23.7.8.1 (01-13-2014) Extending Statute of Limitations for Tip Examinations of Employees (Form 1040)

- (1) Form 1040 is a multi-purpose tax return reporting both income and FICA taxes (i.e., social security tax, Medicare tax, and Additional Medicare Tax). If the employee:
- Did not report any FICA taxes on the return (i.e., the employee did not attach Form 4137 and make an entry on Form 1040 to report FICA tax (Line 23 for 2020 Form 1040)), or
 - Did not attach Form 8919, Uncollected Social Security and Medicare Tax on Wages, and make an entry on Form 1040 to report FICA tax (Line 23 for 2020 Form 1040), or
 - Did not attach Form 8589, Additional Medicare Tax, and make an entry on Form 1040 to report FICA tax (Line 23 for 2020 Form 1040).

The period of limitations does not begin to run and an assessment of FICA taxes may be made at any time. Therefore, social security tax, Medicare tax, and Additional Medicare Tax on unreported tips can be assessed even if the statute of limitations has expired for the assessment of income taxes. (See Rev. Rul. 79-39, 1979-1 C.B. 435).

- a. Form 872, Consent to Extend the Time to Assess Tax, or Form 872-A, Special Consent to Extend the Time to Assess Tax, is used to extend the statute for assessing FICA taxes on tips if those forms specify that they relate to those specific taxes. Thus, the kind of tax to specify on the consent is "Social Security and Medicare tax on tips." If Additional Medicare Tax applies, specify "Social Security tax, Medicare tax, and Additional Medicare Tax on tips" on the consent
- b. If income tax and FICA taxes were reported on the same return, the statute for assessment of additional FICA taxes is the same as the statute for the income tax.
- c. If FICA taxes were not reported on the return, there is no statute on the assessment of FICA taxes and an extension is not necessary in order to assess FICA taxes. See Rev. Rul. 79-39, 1979-1 C.B. 435.

- (2) Use Form 872 (or Form 872-A) to extend the statute for assessing both income tax and FICA taxes on the employee's unreported tip income if the tipped employee reported any FICA taxes on the employee's Form 1040 and the assessment statute of limitations must be extended. See IRM 25.6.22.6.10.2, FICA Tax on Tips Not Reported to Employer. For additional details on employee tip examinations and statute extensions, see IRM 4.19.15.26, Correspondence Exam Tip Program.

4.23.7.9
(01-13-2014)

IRC Section 45B Credit

- (1) The IRC 45B credit applies to employers who operate a food or beverage establishment where tipping is customary and where food or beverages are served for either on- or off-premises consumption. IRC 45B allows an income tax credit to food and beverage businesses for the share of employer's FICA taxes paid with respect to certain employees' tip wages. The employer can claim the income tax credit whether or not the employee reports the tip wages to the employer. Form 8846, Credit for Employer Social Security and Medicare Taxes Paid on Certain Employee Tips, is used to compute the credit.

Note: Additional Medicare Tax is only imposed on the employee. There is no employer share of Additional Medicare Tax. Thus, Additional Medicare Tax has no effect on an employer's IRC 45B credit.

- (2) The taxpayer entitled to the credit is the employee's employer. This is generally the employer under the common law, unless there is another entity that has control of the payment of the wages (e.g., an IRC 3401(d)(1) employer). The application of the common-law rule is a factual determination. Furthermore, the determination of whether an entity is an IRC 3401(d)(1) employer is also a question of fact. See, for example, TAM 201347020, which held that a professional employer organization (PEO), was not eligible to claim the IRC 45B credit on tips received by its clients' employees because it was not in control of the payment of wages to the employees within the meaning of IRC 3401(d)(1).
- (3) PEOs (also commonly known as employee leasing companies) may designate themselves as the employer. A number of court cases have found that a PEO is neither the common law employer nor the IRC 3401(d)(1) employer. Thus, the examiner must first determine, through an examination, who is the employee's common-law employer or the IRC 3401(d)(1) employer before the examiner can determine who is entitled to the credit.
- (4) **For tips received prior to January 1, 2007:** For tips received before January 1, 2007, the IRC 45B credit cannot be offset against the alternative minimum tax (AMT). Pursuant to IRC 38, a taxpayer may claim a general business credit which consists of the aggregate credits identified in IRC 38, including the IRC 45B credit. However, the general business credit is limited by statute. Under IRC 38(c), the credit is computed based on the taxpayer's "net income tax," which is defined as the taxpayer's regular tax liability and AMT liability reduced by allowable credits, and the taxpayer's "net regular tax liability" which is defined as the taxpayer's regular tax liability reduced by the same credits. While the IRC 45B credit may be used to reduce the taxpayer's regular income tax liability, it may not be used to reduce the taxpayer's AMT liability.
- (5) **For tips received after December 31, 2006:** A new provision signed into law on May 25, 2007 allows the IRC 45B credit to be used to offset the AMT liability. The amount of the credit is based on the amount of tips in excess of those treated as wages for purposes of the Fair Labor Standards Act as in

effect on January 1, 2007. (i.e., the tip credit is determined based on a minimum wage of \$5.15 per hour.) Therefore, if the amount of the minimum wage increases, the amount of the tip credit will not be reduced.

- a. The provision applies to tips received for services performed after December 31, 2006.
 - b. Only those credits determined in taxable years ending after December 31, 2006, can be applied against alternative minimum tax. Any credits determined prior to January 1, 2007 and being carried forward cannot be used to offset any alternative minimum tax calculated for years after December 31, 2006. Any credits determined after December 31, 2006, can be used to offset employer's regular tax and alternative minimum tax (AMT) liability by being carried back to prior years or carried forward to subsequent years.
- (6) If the employer pays additional tax as a result of an employment tax examination on unreported tips, the employer may be entitled to an additional IRC 45B credit. If so, the IRC 45B credit is available to the employer in the year the IRC 3121(q) FICA tax liability is paid and not the year in which the unreported tips were received by the employee.

4.23.7.10
(05-10-2021)
**Tip Rate Determination
and Education Program
(TRD/EP)**

- (1) The Tip Rate Determination and Education Program (TRD/EP) was designed to promote compliance by industry employers and employees with the provisions of the Internal Revenue Code relating to tip income and to reduce disputes under IRC 3121(q). The TRD/EP was established in the early 1990's. Tip Agreements were designed to enhance administration of the tip program by both the Employer and the IRS and to facilitate and promote the use of current financial information technology in the tip reporting process. Tip Compliance Agreements offer the following:
 - a. Taxpayer education, and
 - b. Voluntary Tip Compliance Agreements
- (2) The IRS initiated the TRD/EP for various reasons, including:
 - a. **Education:** To help tipped employees and their employers improve their understanding of the laws regarding the federal tax treatment of tips and enhance tax compliance using voluntary tip compliance agreements,
 - b. **Simplification:** To make it easier for tipped employees to calculate their tips, report their tips, and pay their taxes, and
 - c. **Burden Reduction:** To reduce the likelihood of a tip examination and ease the financial burdens associated with a tip examination.
- (3) Voluntary tip agreements are generally available to employers in industries where tipping is customary. Employers interested in these programs must be substantially compliant with their tax filings and demonstrate solid internal controls for tip reporting. Agreements offered to employers are signed by both parties. The employer commits to satisfy certain obligations set forth under the particular agreement. If employers and employees remain in compliance with the tip agreement, they are generally afforded tip audit protection. Current TRD/EP agreements include:
 - a. Tip Rate Determination Agreement (TRDA),
 - b. Tip Reporting Alternative Commitment (TRAC),
 - c. Employer-designed TRAC (EmTRAC), and
 - d. Gaming Industry Tip Compliance Agreement (GITCA).

- (4) These voluntary tip compliance agreements help reduce taxpayer burden ordinarily associated with the IRS assessments of additional FICA taxes on unreported tip income. The IRS, through outreach and education, helps business owners and their tipped employees understand the tax laws related to tip income reporting so that they can more accurately meet their reporting and filing obligations.
- (5) The employer can choose not to enter into the program, but instead, institute its own program or actions to bring itself and its employees into compliance.
- (6) The TRD/EP is a voluntary program for both the employer and the IRS. Employers are screened for suitability. Screenings do not increase the likelihood of an audit. Employers can request a tip agreement or choose not to participate in the program at all. An employer who participates can only have one agreement at a time. The various agreements can be accessed at *irs.gov* under Market Segment Understandings.
- (7) .

4.23.7.10.1
(01-22-2010)
**Tip Compliance
Agreements**

- (1) There are specific tip compliance agreements for the food and beverage, cosmetology and barber, and gaming (casino) industries. There are also generic tip agreements that permit all other tipping industries to participate in the program. The TRDA and TRAC agreements are available to employers in all industries, including restaurants and bars, salons and barber shops, taxicab and limousine companies, airport skycap companies, car wash operations, and tour guide companies. The GITCA is available only to employers in the gaming industry. The EmTRAC is available only to food and beverage employers.
- (2) Some employers will find one agreement more beneficial, some will prefer another agreement, and some will choose not to participate in the program at all. As this is a voluntary program, employers do not have to participate. Those who choose to participate may participate in only one agreement at a time. The various agreements can be accessed at *irs.gov* under Market Segment Understandings.

4.23.7.10.2
(05-10-2021)
**Solicitation of Tip
Compliance Agreements**

- (1) IRS employees will under no circumstances use or imply the threat of an audit when soliciting participants to sign up for any tip compliance agreement. Section 3414 of the IRS Restructuring and Reform Act of 1998 specifically prohibits the threat of an audit to coerce taxpayers into signing a TRAC agreement.
- (2) The mission of the IRS is to provide taxpayers with top quality service by helping them understand and meet their tax responsibilities and to apply the tax law with integrity and fairness to all. The purpose of a tip compliance agreement is to educate employers in industries where tipping is customary on their tip income reporting responsibilities, and to promote tip reporting compliance among their tipped employees.
- (3) There are pre-qualification procedures to follow before the agreement can be approved:
 - a. When assigned a tip agreement request, read the entire agreement and understand the commitments specified for the IRS and for the Employer.

- b. Contact the employer and review the Employer Commitment sections of the agreement. The Employer needs to demonstrate that everything is in place to satisfy these commitments, before the IRS will approve the agreement.
 - c. Evaluate the employer's level of compliance and ensure that all federal reporting, filing, and payment compliance are current.
 - d. If the Employer is a large food or beverage establishment, request the most currently filed Form 8027, Employer's Annual Information Return of Tip Income and Allocated Tips.
 - e. If the Employer is not a food or beverage establishment, request the previous tax year's report for charged sales and tips and cash sales and tips. Compare to tips reported by employees through the W-3 filing to determine substantial tip reporting compliance.
- (4) After the analysis of the information, if the IRS representative determines that the request cannot be approved, contact the taxpayer to explain why. Follow up the telephone contact with Letter 4761, Agreement Request Denial. Letter 4761 explains to the taxpayer why the request to participate in a tip compliance agreement is not being approved. The letter will give the reason or reasons.
 - (5) With the consent of the IRS, any tip employer may participate in a tip agreement. Either the IRS or an employer may suggest the employer's potential participation in the program. The IRS's decision to refuse participation by any employer in this program is not subject to review.
 - (6) The person designated by the employer to sign a tip agreement must have the authority to legally bind the company. The person is also responsible to ensure all internally affected employees are notified of the agreement and the requirements.
 - (7) If a taxpayer expresses an interest to enter into a voluntary tip compliance agreement during the course of an ongoing examination, the examination must first be completed prior to discussing participation in the program. The taxpayer must understand that where the tax has been determined, a tip agreement will not eliminate any balance due. At the conclusion of the examination, examiners can begin the process of implementing the tip agreement. Note that time on the case for securing an agreement is documented separately.
 - (8) Once the audit has been finalized, the tip agreement request can be referred to NTRC for review and consideration.
 - (9) **Activity Codes:**
 - Employment tax examiners should use activity code "551" and Project Code "0985" to report time spent soliciting tip agreements with Source Code "99" and MFT "C0" (C zero).
 - The Tracking Code will depend on the market segment. Contact an NTRCP Analyst for the list of Tracking Codes.
 - For tip agreement addendums, use Activity Code "551" and Project Code "0986".
 - For time spent performing compliance reviews on agreement participants, use Activity Code "551" and Project Code "1104".
 - Compliance reviews are discussed later.

- (10) The authority to approve a Tip Reporting Alternative Commitment (TRAC) agreement or a Tip Rate Determination Agreement (TRDA) is found in SB/SE Delegation Order No. 1-23-20. The Authority to approve a Gaming Industry Tip Compliance Agreement (GITCA) is found in Order No. 4-34 (rev. 1).
- (11) For tribal agreements, ITG Group Managers are authorized to sign the tip agreements under Delegation Order 4-34 (rev. 1).

4.23.7.10.3
(01-22-2010)
Tip Rate Determination Agreement (TRDA)

- (1) A Tip Rate Determination Agreement (TRDA) requires the employer to work with the IRS to arrive at a tip rate for the various worker occupations in the establishment.
- (2) At least 75 percent of tipped employees must agree to participate by signing a Tipped Employee Participation Agreement (TEPA) with the employer.
- (3) Participating employees comply by reporting tips at or above the rate determined in the agreement for their job category. However, if the employee keeps an actual log of tips, the employee is then only required to report the actual tips received.
- (4) If employees fail to report tips at or above the determined rate, the IRS may audit those employees' tax returns.
- (5) The TRDA does not have any specific education requirement but the IRS provides assistance to help employees understand their tax responsibilities and emphasizes benefits for complying.
- (6) TRDA is available for all industries where tipping is customary. The TRDA can be accessed from at *irs.gov* under Market Segment Understandings.

4.23.7.10.3.1
(01-22-2010)
Revoking TRDA Agreements

- (1) Revoking any tip agreement requires timely historical documentation on the actions the IRS took to help the employer and its employees come into compliance once a decline in reported tips was identified. If a tip agreement is to be terminated, a request for approval must be sent to the Director of Specialty Examination, prior to notifying the taxpayer (employer) through the NTRCP Program Manager. The NTRCP office will review the request to terminate the agreement and forward to the Director of Specialty Examination for written approval. Examples include:
 - a. When, at the end of two consecutive calendar quarters, fewer than 75 percent of the employees in the occupational categories are participating under the agreement
 - b. When the employer fails to file the necessary tax returns
 - c. When the employer fails to pay and deposit taxes
 - d. When the employer fails to maintain records or to make the required records available to the IRS or the IRS or other federal agency pursues an administrative or judicial action, examination, investigation, or proceeding involving the employer or related party
- (2) Request for approval to terminate a tribal agreement should be sent to the ITG Tip Compliance Coordinator. The Director of Indian Tribal Government must approve all terminations on any Indian Tribal Government tip agreement.

- (3) After written approval is received, the NTRC Program Manager must sign the letter notifying the taxpayer of the termination and state the reasons for the termination. Field offices should use Letter 3346, Tip Program Participation Termination Letter, for this notification.
- (4) An employer may terminate a TRDA at any time.
- (5) If the employer is otherwise complying with the TRDA, the agreement should not be revoked. As a general rule, individual tip examinations will be initiated on the most egregious noncompliant employees.
- (6) For tribal agreements, after written approval is received from the designated Indian Tribal Government (ITG) official, the authorized ITG Group Manager must sign the letter notifying the taxpayer of the termination and state the reasons for the termination. For tribal tip agreements, the designated ITG official may prospectively revoke or terminate a TRDA.

4.23.7.10.4
(01-22-2010)

**Tip Reporting Alternative
Commitment (TRAC)**

- (1) Under the Tip Reporting Alternative Commitment (TRAC) agreement, the employer agrees to institute and maintain an employee educational training program with respect to their tip reporting obligations. Unlike a TRDA, a TRAC agreement does not require that the employer work with the IRS to arrive at a tip rate for any of the worker occupations in the establishment. However, during the meeting with the Employer to discuss the agreement, the IRS representative responsible for executing the agreement, should jointly review the employer's books and records to identify the average tip rates for cash and charged tips being received by the tipped employees. This includes a discussion with the directly tipped employees to arrive at tip out percentages (tips shared with other workers) and stiff (term used when a customer does not leave a tip). This will show the employer and the employees if the employees are reporting their tips accurately. Inform the employer and employees that the IRS will monitor tip reporting on the Form 941 and on Form 8027 if pertaining to a food or beverage business. A TRAC requires employers to:
 - Establish a reasonable procedure for accurate tip reporting by all tipped employees,
 - Institute a training program to educate employees of their tax reporting obligations as they relate to tips, and
 - Comply with all federal tax requirements regarding the filing of returns, paying and making tax deposits, and maintaining required records.
- (2) TRAC's were originally offered to the food and beverage industry, but have now been extended to all industries where tipping is customary. A specific TRAC agreement is available for the cosmetology and barbering industry containing characteristics unique to this industry.
- (3) A TRAC affects all employees. As long as both the employer and employees are complying with the requirements under the agreement and all tips are being reported accurately, no tip audits will be initiated on either the employer or the employees. The IRS will only terminate a TRAC agreement if the employer fails to meet the terms of its commitment.
- (4) To qualify for a TRAC agreement, the business must have charge receipts that show a charged tip. That is, a reasonable amount of the business's gross receipts must be from charged receipts that included a charged tip. There is no set percentage - as long as the amount of charged receipts with a charged tip is sufficient to determine the average charged tip rate.

- (5) If the reporting of tip wages by tipped employees has not improved after six months from securing the TRAC agreement, the employer will be notified. Specific taxpayer correspondence will notify the employer of any shortfalls in satisfying the agreement commitments and remind the employer about tip reporting obligations and the consequences for failing to comply with the law.
- (6) If the underreporting occurs because of the employer's system, the employer will be offered suggestions for improvements or changes needed to be made to the procedures. If, after a reasonable period the employer has not corrected the procedures, the employer may be referred for a tip examination and/or the agreement may be terminated. Implementation of these follow-up procedures allows the establishments to gauge how well their education requirement is being fulfilled and whether the employees are complying with their tip reporting requirements.
- (7) The TRAC can be accessed at *irs.gov* under Market Segment Understandings.

4.23.7.10.4.1
(05-10-2021)
**Revoking TRAC
Agreements**

- (1) Revoking any tip agreement requires the case file to have timely historical documentation on the actions the IRS took to help the employer and its employees come into compliance once the decline in reported tips was identified. If a tip agreement is to be terminated, a request for approval must be sent to the Director of Specialty Examination, prior to notifying the taxpayer (employer), through the NTRC Program Manager. Examples include:
 - a. When the employer fails to file the necessary tax returns,
 - b. When the employer fails to pay and deposit taxes.
 - c. When the employer fails to maintain records,
 - d. When the employer fails to make the required records available to the IRS,
 - e. When the employer fails to substantially comply with the educational program or the tip reporting requirements,
 - f. When the employer fails to maintain records or to make the required records available to the IRS, or
 - g. When the IRS or other federal agency pursues an administrative or judicial action, examination, investigation, or proceeding involving the employer or related party.
- (2) An employer may revoke a TRAC agreement at any time.
- (3) In the case of an employer with establishments in more than one key area and where one or more establishments are not complying with the requirements under an agreement, the IRS, through the controlling office, will notify the employer corporate headquarters. The IRS will allow the corporate headquarters a reasonable amount of time to get these establishments into compliance (for example, 90-days). If the noncompliant unit or units do not come into compliance, the Program Manager may request approval to revoke the entire agreement. The TRAC employer needs to understand that internal controls must be consistent for all establishments to ensure the Agreement as a whole complies with accurate tip income reporting.
- (4) If the employer is otherwise complying with the TRAC agreement, the agreement should not be revoked. As a general rule, individual tip examinations should be initiated on the substantially noncompliant employees.

4.23.7.10.5
(01-22-2010)
**EmTRAC –
(Employer-designed
TRAC) Program**

- (1) The Employer-designed TRAC (EmTRAC) program retains many of the provisions available under the TRAC agreement. The employer must establish an educational program that trains employees that the law requires them to report all their cash and charged tips to their employer. Education must be furnished for newly hired employees and quarterly for existing employees. The EmTRAC program provides an employer with considerable latitude in designing its educational program and tip reporting procedures, which the employer may combine.
- (2) The EmTRAC program is available only to employers in the food and beverage industry.
- (3) Procedural and other information regarding the EmTRAC program can be found in Notice 2001-1.
- (4) Rules for terminating or revoking an EmTRAC are the same as for a TRAC agreement.

4.23.7.10.6
(12-18-2012)
**Gaming Industry Tip
Compliance Agreement
(GITCA)**

- (1) The Gaming Industry Tip Compliance Agreement (GITCA) Program was designed to promote compliance by gaming industry employers and employees with the provisions of the Internal Revenue Code relating to tip income and to reduce disputes under Section 3121(q). The Gaming Industry Tip Compliance Agreement Program was established in May of 2003 by Rev. Proc. 2003-35. The model GITCA used by the IRS and gaming industry employers was updated in 2007 and is now administered under Rev. Proc. 2007-32 and Rev. Proc. 2020-47. The new model GITCA agreement was revised to enhance administration of the GITCA program by both the employer and the IRS and to facilitate and promote the use of current financial information technology in the tip reporting process. The Rev. Proc. 2007-32, including the GITCA and related appendices, can be found at: http://www.irs.gov/irb/2007-22_IRB/ar13.html. Please see Rev. Proc. 2020-47 for an update to potentially lengthen the term of the initial rate review agreement to up to five years.
- (2) The Gaming Industry Tip Compliance Agreement offers the following:
 - a. A two-tiered participation requirement,
 - b. Safe harbor from tip-related examinations for participating tipped employees and employer,
 - c. Electronic filing of Form 8027 or substitute form used to provide the Form 8027 required data,
 - d. No allocated tip requirement for participating employees,
 - e. Flexibility due to economic considerations, and
 - f. A self-certification option which reduces the burden of reporting individual payroll and tip information.
- (3) The gaming industry offers many unique occupations and terminology. For more information on gaming occupations, see the following Bureau of Labor Statistics website: www.bls.gov/
 1. Select "Occupational Outlook Handbook" (under Publications)
 2. Select "A-Z Index"
 3. Select (G) "Gaming Services Occupations"

4.23.7.10.6.1
(12-18-2012)
GITCA Background

- (1) The GITCA, like all other tip agreements, is voluntary. However, once an agreement is entered into by the gaming establishment, the tipped employees will have to decide whether to participate in the program or not starting with the tip agreement effective date. Participation in the program means that the employee will report at or above the established tip rate for their particular worker category. If the employee decides to participate in the program, generally, the employer will automatically calculate the tip income reported for the employee and include that amount on the employee's Form W-2 at the end of the year.
- (2) Under the GITCA Program, a gaming industry employer and the Internal Revenue Service work together to reach an agreement that establishes minimum tip rates for tipped employees in specified occupational categories, prescribes a threshold level of participation by the employer's employees, and reduces compliance burdens for the employer and enforcement burdens for the IRS.
- (3) With the consent of the IRS, all employers operating a gaming establishment may participate in the GITCA Program. Either the IRS or an employer may suggest the employer's potential participation in the program. The IRS's decision to refuse participation by any employer in this program is not subject to review.
- (4) An employer who complies with the reporting requirements of Section V of its GITCA, and participating employees of the employer who report in accordance with the agreement, will be deemed to be in compliance with the reporting requirements of IRC 6053 for the taxable periods during which the agreement remains in effect.
- (5) Rev. Proc. 2007-32 went into effect on May 2, 2007 and superseded Rev. Proc. 2003-35. All GITCAs executed pursuant to Rev. Proc. 2003-35 will remain in effect until the expiration date set forth in that Agreement, unless superseded by the execution of a Gaming Industry Tip Compliance Agreement under section 4.02 of Rev. Proc. 2007-32 and Rev. Proc. 2020-47.

4.23.7.10.6.2
(12-18-2012)
**Gaming Industry Tip
Compliance Agreement
(GITCA) Benefits and
Responsibilities**

- (1) The GITCA is an enforceable agreement that must be signed by the employer's designated representative and the IRS designated official. The person designated by the employer to sign the GITCA must have the authority to legally bind the company/casino. Employees who choose to become participants in the program must sign the Appendix C, "Gaming Employee Tip Reporting Agreement," or similar document and also assume certain responsibilities to maintain their status as participating employees. The similar document can be an agreement that contains similar wording outlined by the employer. Section IV, Employee Participation of the GITCA, discusses the employees' responsibilities as an eligible and participating employee.
- (2) Generally, the IRS and the employer work together to establish tip rates for tipped employees in specified occupational categories. These rates are determined using methodologies in accordance with generally accepted accounting principles.

4.23.7.10.6.2.1
(12-18-2012)

Employer's Benefits and Responsibilities

- (1) The employer agrees to encourage eligible employees to become participants in the program and sign the Appendix C, Gaming Employee Tip Reporting Agreement. In addition, the employer agrees to maintain the Gaming Employee Tip Reporting Agreements for the applicable period (statute of limitation on employment tax assessment) and make the agreements available to the IRS upon request. See Section V, Paragraph A of the GITCA.
- (2) The employer agrees to make tax withholding based upon tips reported and include all reported tips in the employee's Wage and Tax Statement, Form W-2. See Section V, Paragraphs B and C, of the GITCA.
- (3) The employer agrees to maintain the following records for at least 4 years after April 15 following the calendar year to which the records relate, and to make those records available to the IRS upon request:
 - a. Employee records. See Section V, Paragraph E(1) of the GITCA for the specific employee information required to be maintained.
 - b. Appropriate gaming establishment records. These records are used in the determination of the tip rates for each specific occupational category. See Section V, Paragraph E(2) of the GITCA for additional information.
 - c. Food and beverage operations records. For each food and beverage venue, the employer will maintain gross receipts subject to food or beverage tipping and aggregate receipts showing charged tips. See Section V, Paragraph E(3) of the GITCA for additional information.
- (4) The employer agrees to furnish the following to the IRS:
 - a. An annual report showing each non-participant. This report is due on or before March 31 for the preceding calendar year. See Section V, Paragraph F(1) of the GITCA for more information. An additional annual report providing the same information about participants is required if the employer is not self-certified. See Section V, Paragraph F(2) of the GITCA for additional information.
 - b. Specific records pertaining to large food or beverage establishments. The report is due on or before the Form 8027 filing date. See Section V, Paragraph F(3) of the GITCA to determine what information is required. If the records show that allocated tips are required to be reported, the employer should report them on Forms W-2 issued to nonparticipating employees tips allocated pursuant to Section 6053 of the Code. The employer is not required to report allocated tips on Forms W-2 issued to participating employees. In addition, the employer is not required to complete the portion of Form 8027 related to tip allocations to participating employees. See Section V, Paragraph F(4) of the GITCA for additional information.
 - c. For each calendar year, the employer will provide a report generated from the employer's time-and-attendance system or payroll processing system that evidences the tip rates utilized by the employer in the preparation of the Forms W-2 and to implement this agreement. This report will contain information showing the tip rates for each occupational category, shift, and outlet. The report will include the total number of the employer's eligible employees as of December 31. The report is due on or before March 31 of the year after the calendar year, or any portion thereof, during which this agreement was in effect.
- (5) The employer receives the following benefits when entering into a GITCA:

- Implements its own tip income reporting program for employees
- Improves knowledge of operations and costs of employees and activities
- Incurs no contingent liability, except for taxes on non-participating employees' tip income
- Is relieved of any employer tip examinations

4.23.7.10.6.2.2
(05-10-2021)

Employee's Benefits and Responsibilities

- (1) All eligible employees may become participating employees if they agree in writing to adhere to certain requirements outlined in the agreement and in the Appendix C, Gaming Employee Tip Reporting Agreement, of the GITCA. For purposes of the agreement, a "nonparticipating" employee is any eligible employee who does not meet the definition of a participating employee, as defined in part IV. F of the GITCA.
- (2) An eligible employee means an individual who performs a job function in an occupational category described in Appendix A, Occupational Categories, Outlets, Shifts, and Tip Rates, of the GITCA and regularly and routinely receives tips, directly or indirectly, of at least \$20 per month.
- (3) A participating employee is an eligible employee who fulfills specific requirements. See Section IV, Paragraphs B, C, and E of the GITCA for additional information.
- (4) A participating employee who revokes the election under the Gaming Employee Tip Reporting Agreement will be treated as a nonparticipating employee for the entire taxable year in which the revocation occurred. The employee may not enter into a new Gaming Employee Tip Reporting Agreement with the employer until January 1 of the following taxable year.
- (5) If a participating employee reports tips to his or her employer in an amount below the tip rate set forth in Section VIII of the agreement, the employee will be deemed to have revoked his or her election under the Gaming Employee Tip Reporting Agreement and will be treated as a nonparticipating employee. The employee may not enter into a new Gaming Employee Tip Reporting Agreement with the employer until January 1 of the following taxable year. See Section IV, Paragraph D of the GITCA for additional information.
- (6) An employee may report tips on the employee's federal income tax return below the tip rates if the employee can substantiate, with adequate books and records, that the employee earned less tip income than would be determined by applying the tip rates. As indicated in Section IV, Paragraph D of the GITCA, this employee would be considered a nonparticipating employee.
- (7) Employees who pool tips or their group representatives (example: token committee) must give the employer a listing of the actual share of pooled tips received by or given to each employee. This listing must reconcile to the tips presented to the employer's cage for cashing. See Section VIII, Paragraph A(1) of the GITCA for additional information.
- (8) Employees receive the following benefits when they participate in the GITCA:
 - a. Increased unemployment compensation coverage,
 - b. Increased retirement – social security or 401K additions by the employee and employer in a matching situation,
 - c. Increased ability to secure loans – mortgage, car, etc. (qualifying),
 - d. Increased worker compensation coverage, and

- e. Protection from tip income examination and related liabilities and penalties.

4.23.7.10.6.2.3
(12-18-2012)
IRS Benefits and Responsibilities

- (1) The IRS will work with the employer throughout the agreement process to establish reasonable tip rates and to educate the employer concerning its rights and responsibilities as provided for in the agreement.
- (2) The employer has the primary responsibility for administering the terms and rates of the agreement once it is signed. However, the IRS is available to assist the employer with questions regarding the administration of the agreement and the employer's related reporting requirements.
- (3) The IRS may not examine a participating employee's tip income for any taxable year that ends after the effective date of the agreement, as long as the participating employee fulfills his or her responsibilities as provided in the agreement and Gaming Employee Tip Reporting Agreement.
- (4) The IRS may not examine the tip income of a participating employee for any taxable year that ends on or before the effective date of the agreement provided that during that prior period the employee was:
 - a. A participant under a predecessor agreement (such as a Tip Rate Determination Agreement (TRDA)) and satisfied all the terms and conditions of that agreement,
 - b. A participating employee under another employer who had a GITCA or predecessor agreement and satisfied all the terms of that agreement, or
 - c. An employer where the individual was not an eligible employee.
- (5) The IRS may continue any ongoing examination of any employees of the employer begun by the IRS before the effective date of the agreement.
- (6) A nonparticipating employee is subject to the full range of compliance and enforcement procedures of the IRS at any time.
- (7) During any taxable year that the agreement is in effect, the IRS may not assess additional tax against the employer pursuant to IRC 3121(q) with respect to the tip income of participating employees unless the participating employee reports additional tip income on his/her federal income tax return. The IRS may assert a liability against the employer pursuant to IRC 3121(q) based on tips received by a nonparticipating employee if the asserted liability is based upon the final results of an audit or agreement of the nonparticipating employee or the reporting of additional tip income by an employee.
- (8) If there is a material breach by the employer of its obligation to maintain or provide the information (reports and documents) listed in the agreement, the IRS will send the employer a notice of demand for the information. If the breach continues, then the IRS is no longer bound by the restrictions on additional assessments.
- (9) The burden to examine tip income will be less for the IRS as a result of executed tip agreements and employee participation.
- (10) The IRS will receive a more consistent stream of revenue generated from tax filings of employers and employees.

4.23.7.10.6.2.4
(12-18-2012)

**Mutual Responsibilities
between the Employer
and the IRS**

- (1) The employer and the IRS agree to meet to discuss the cause of a decline in participation if employee participation is below 75 percent of eligible employees.
- (2) The IRS and the employer agree to start discussions as to any appropriate revisions needed to the agreement no later than six months prior to the termination date.
- (3) The agreement can be terminated upon the joint agreement of the employer and the IRS, without the consent of any participating employee.

4.23.7.10.6.3
(05-10-2021)

**Tip Rate Review
Background**

- (1) IRM 4.23.7.10, Tip Rate Determination and Education Program (TRD-EP), is a compilation of various subsections from IRM 4.23.1, Employment Tax - Employment Tax Objectives, Organization, and IRM 4.23.2, Employment Tax responsibilities and Coordination with other Functions, in an effort to provide a consolidated overview of Tip Rate Reviews.
- (2) Definitions for the purposes of this section, IRM 4.23.7.10, are as follows:
 - a. Property: The Taxpayer/Employer
 - b. Establishment: Physical location of Taxpayer's business
 - c. Reviewer: Reference for an Examiner who conducts Rate Reviews
 - d. Project Team: Group assembled by the Taxpayer to work in cooperation with the Reviewer; this may include employees from the following departments: Finance, Program Analysts, Payroll, Human Resources, Food and Beverage, Gaming Managers and Front Services Managers (if applicable)
- (3) All Tip Agreements are voluntary between the IRS and a Property. Once an agreement is entered into by the Property, the tipped employees may have to decide whether to participate in the program or not. Properties may require mandatory participation conditional upon the state's Department of Labor laws. Participation in the program means that the employee will report at or above the established tip rate for their particular worker category. If the employee decides to participate in the program, generally, the Property will automatically calculate the tip income reported for the employee and include that amount on the employee's Form W-2 at the end of the year.
- (4) Under the Tip Compliance Program, the IRS and a Property work together to reach an agreement that establishes minimum tip rates for tipped employees in specified outlets, occupational categories, and shifts, prescribes a threshold level of participation by the Property's employees, and reduces compliance burdens for the Property and enforcement burdens for the IRS. With the consent of the IRS, all taxpayers operating a Property whose employees earn tip income may participate in the Tip Compliance Program. Either the IRS or a Property may suggest the Property's potential participation in the program. The IRS's decision to refuse participation by any Property in this program is not subject to review.
- (5) A Property who complies with the reporting requirements will be deemed to be in compliance with the reporting requirements of IRC 6053 for the taxable periods during which the agreement remains in effect.

4.23.7.10.6.4
(05-10-2021)

Control of Cases and Establishment of Cases

- (1) Most Employment Tax Rate Reviews of SB/SE and LBandI taxpayers are established by National Tip Reporting Compliance Program (NTRCP). If established by another Employment Tax territory: East, Mid-States, West, Large Case, the activities are coordinated with a Territory Tip Coordinator, NTRCP Analyst or NTRCP Group Manager. NTRCP completes the final review of tip rates prior to the tip agreement being sent to the Property.
- (2) Cases originating in Classification will have the project and tracking code on the controls prior to receipt in the group. Exhibit 4.23.7-1, Codes to Complete Form 5345-NTRC, for a listing of these codes.
- (3) See applicable agreement for details and contact the NTRCP Analyst for guidance.
- (4) If an examiner is assigned a Rate Review case not previously established on ERCS or expands an open review to include additional Properties, the examiner will need to complete the Form 5345-NTRC and submit to their manager for approval and ERCS input.

Note: Rate review cases are not established on AIMS

Specific input items to include in the Form 5345-NTRC are:

- a. Contact Person, Title, Phone Number and Email is the person the Reviewer will be in contact with at the Property for the rate review
- b. Tax period is not tied to a return quarter, instead it is the current Year and Month the Rate Review case is established in
- c. Special Project and tracking coding have been established for these Rate Review cases: See Exhibit 4.23.7-1, Codes to Complete Form 5345-NTRC, for a listing of these codes

4.23.7.10.6.5
(05-10-2021)

Issue Management System (IMS)

- (1) All Reviewers trained in the use of the Issue Management System (IMS) are required to use IMS for all case management, regardless of the type of case being worked. See IRM 4.23.4.4, Guide for Examiners Using Issue Management Systems (IMS), and subsequent sections.

Note: ET Case files must contain the ETLS mandatory leadsheets. See IRM 4.23.4-1, Mandatory Items – IMS General Case Requirements.

- (2) Inputting Time into IMS: Reviewers who are required to input technical time use IMS for time input. See IRM 4.23.4.4.4, Charging Time on Cases/Returns and Issues, and IRM 4.9.1.6.2, How to input time on ERCS and Issue Management System (IMS), for more details.

4.23.7.10.6.6
(05-10-2021)

Tip Review Employment Tax Lead Sheets (ETLS)

- (1) The work paper system is designed to facilitate consistent organization of case files and eliminate duplication. NTRCP Employment Tax Lead Sheets (ETLS) is a workbook similar to the SBSE Employment Tax Lead Sheets but modified to be specific to Rate Review cases.
- (2) Reviewers must use the administrative and issue lead sheets on the Knowledge Management (KM) website under Tips. Check the KM for the latest version of the Tip Review ETLS.

- (3) Administrative lead sheets address the administrative items requiring comment by the examiner. They are also used as a guide to assist the Reviewer with properly completing the Rate Review case.
- (4) The administrative lead sheets listed below are mandatory for Reviewers and are generally applicable to all Rate Review cases:
 - a. Form 4318, Examination Workpapers Index
 - b. Form 9984, Case Activity Record
 - c. Work Paper 105, Pre-Plan Administrative Lead Sheet
 - d. Work Paper 120, Initial Contact Check Sheet
 - e. Work Paper 125 Section – Contains the Interview and Tour of Business notes
 - f. Work Paper 130, Related Properties and Leased Outlets Lead Sheet
 - g. Work Paper 200, Employer -Computed Tip Reporting Process Certification
 - h. Work Paper 300, Tip Rate Approval Form
- (5) The sections of the Form 4318 are arranged by specific purpose:
 - a. Work Papers 400 through 460, Tipped Outlet Lead Sheets
 - b. Work Paper 505, Employer Meetings
 - c. Work Paper 506, Employee Meetings
 - d. Work Paper 610, Information Document Requests
 - e. Work Paper 910, Correspondence
 - f. Work Paper 920, Current Rates/Agreements – This is the section which the final Agreement signed by both the Authorized Signor of the Property and the NTRC Program Manager is stored
 - g. Work Paper 930, Prior Rates/Addendums/Extension – This section is only applicable for properties that had a previous agreement with the IRS
 - h. Work Paper 935, F8027 Analysis
 - i. Work Paper 940, MOU for Secure Email
 - j. Work Paper 950, Case Building
 - k. Work Paper 980, IDRS Research
- (6) An issue leadsheet is required for all Tipped Outlets at the Property. If a Tipped Outlet does not have a specific lead sheet, a generic lead sheet must be used. Each Tipped Outlet will require a separate leadsheet, Outlets are to be organized in the following sections:
 - a. Work Paper 400 Section – Contains the Gaming Outlet Lead sheets
 - b. Work Paper 410 Section – Contains the Food Outlet Lead sheets
 - c. Work Paper 420 Section – Contains the Beverage Outlet Lead sheets
 - d. Work Paper 430 Section – Contains the Front Service Outlet Lead sheets
 - e. Work Paper 440 Section – Contains the Transportation Outlet Lead sheets
 - f. Work Paper 450 Section – Contains the Spa Outlet Lead sheets
 - g. Work Paper 460 Section – Contains the Golf Outlet Lead sheets
- (7) Workpapers support the information included on the lead sheets. Each Tipped Outlet requires the inclusion of supporting documentation for each rate calculation including but not limited to rate calculation worksheets, Point of Sale (POS) and Financial reports, and payroll reports.

Note: See IRM 4.23.4.2, Workpapers, and subsequent sections for guidance on general workpaper preparation. For additional Lead Sheet guidance, see also IRM 4.10.9.6, Lead Sheets.

4.23.7.10.6.7
(05-10-2021)

Rate Review Procedures

- (1) The IRS's goal is to reduce the tip reporting tax gap and decrease taxpayer burden through employer and employee participation in TRD/EP. See IRM 4.23.7.1, Program Scope and Objectives.
- (2) The Streamline Method for rate reviews and the Traditional Method for rate reviews use the same process to arrive at tip rates, including; calculation methods, objective factors, and subjective factors. There are some differences between the Streamline Method and the Traditional Method for conducting rate reviews.
- (3) The Internal Revenue Service is always looking for methods to reduce internal administrative burden and external compliance burden. The Streamline Method for rate reviews is the preferred process that:
 - a. Modernizes the rate review process by leveraging electronic data
 - b. Engages participants to better understand the voluntary program
 - c. Provides consistency through a uniform approach
 - d. Reduces rate review cycle time through collaboration and increased e participation

4.23.7.10.6.7.1
(05-10-2021)

Completion of the Templates

- (1) Traditional Method: Templates completed by the IRS
- (2) Streamline Method: Templates completed by the Property (preferable method) with guidance and assistance from the IRS. Streamline engages the Property more in the rate calculation process:
 - a. The Property calculates the rate providing early opportunities to identify errors
 - b. Rate calculations also provide the Property with an understanding of rate changes or fluctuations
 - c. The Property determines the appropriate staff and amount of their involvement in the calculation process, as to not impede their business
 - d. The IRS is "on site" less frequently, the rate review is less intrusive to the operation of the business

4.23.7.10.6.8
(05-10-2021)

Criteria to be Considered Tip Income

- (1) Payments must meet the following criteria to be considered as tips:
 - a. The payment must be made free from compulsion;
 - b. The customer must have the unrestricted right to determine the amount;
 - c. The payment should not be the subject of negotiations or dictated by employer policy; and,
 - d. Generally, the customer should have the right to determine who receives the paymentIf any of the above factors are missing, there is doubt that the payment is a tip. Rev. Rul. 2012-18 provides specific examples of amounts characterized as tips and service charges to illustrate the application of these factors.

- (2) If a business adds service charges (such as “auto-gratuities”) to customers’ bills which it distributes to employees, the business should characterize the distributed service charges as non-tip wages, not as tips.
- (3) The facts and circumstances around a payment are the determinative factors in the proper treatment of a payment, not the employer’s or employee’s characterization or treatment.
- (4) Rev. Rul. 2012-18 (Auto Gratuities/Service Charges) and H.R.5180 - Tip Income Protection (TIP) Act of 2018 (Supervisors and Tips) should be discussed and provided to the Property.
- (5) Tip-Sharing, the sharing of tips with non-directly tipped employees, is not allowed in all states. The Reviewer will need to research the applicable law for each state dependent upon the location of the Property.

4.23.7.10.6.9

(05-10-2021)

**Working Newly Opened
Properties or Outlets
versus Existing
Properties**

- (1) When assigned a tip agreement request, the Reviewer should first become very familiar with the agreement. Take the time to read the entire agreement and understand the benefits and responsibilities specified for the IRS, for the Employer and for the Employee.
- (2) An initial agreement for a new Property or newly opened outlet within an established Property requires the Reviewer to prepare rates based on comparables. Comparables are rates calculated using similar properties who have established tip rates. Items to consider are staffing (for e.g. overstaff to ensure good customer service may mean lower tips), proximity between customer and employee (e.g., shorter walks to deliver food and drinks usually means higher sales and tips), cost to play or eat (e.g., high priced menu items usually mean higher tip rates). To begin the process:
 - a. Ask the Property who they see as its competitors. The Property should identify the expected customer base and name three to five comparable or competitive Properties. (Remember: high-end Properties compete with high-end Properties, not value-minded Properties)
 - b. Research newspaper articles on the building, planning or licensing of the Property for comments from management and owners
 - c. Consider similar Properties owned or related to the Newly Opened Property.
 - d. It is important to remember that similar Properties do not have to be located in the same region but should share some general features;
 - e. Develop rates using an average for each occupation at the comparable Properties to determine the proposed comparable rates for the new Property.
 - f. Review the proposed rates for reasonableness and adjust, as necessary, based upon any known factors that may affect the rates
 - g. Do not disclose the Properties used to prepare the comparable rates
 - h. Initial rates are usually set for a 12 to 18 month period (e.g., rest of the current year, plus the next year). Agreements expire December 31, YYYY. Tip rates are never negotiated. They are calculated with financial data. See Employment Tax Tip/Gaming Training material ITM 28136-002, Catalog Number 53650W for more information on the calculation of tip rates.

- (3) For a Property that is not newly opened but new to an agreement and wants to execute a tip agreement, the reviewer will use financial data in setting the tip rates. This is true as well when conducting a review of an existing agreement at a Property.
 - a. Financial data, POS data, payroll records and other related information, such as Form 8027, Employer's Annual Information Return of Tip Income and Allocated Tips, or related information is used extensively for all Food and Beverage oriented positions
 - b. For other tipped positions, the computations are based on financial and payroll data, and other supporting operational data such as parking tickets for valets, room occupancy or bell runs for bell departments, etc.
 - c. Subjective data such as average tip per drink and stiff rate should be compared and consideration given to using consistent factors among Properties of a similar type (such as local oriented establishments, large resort hotel/casinos, small bar/casino operations, etc.); the NTRCP has prepared suggested parameters for the subjective factors

Tip rates are not negotiated they are calculated. See Employment Tax Tip/ Gaming Training material ITM 28136-002, Catalog Number 53650W for more information on the calculation of tip rates.

4.23.7.10.6.10
(05-10-2021)
**Pre-Contact Analysis
and Research For Tip
Agreements**

- (1) The Properties requesting any tip agreement must show readiness or compliance to implement the agreement. Examiners will conduct and document a pre-contact analysis which will include some or all the following:
 - a. Research the Property's internet sites to get a listing of entertainment outlets, restaurants, bars and other offerings within the establishment; this will provide a general outline of which positions the Reviewer should be seeking rates for during the agreement process
 - b. Research IDRS to determine the taxpayer's filing and payment compliance and to secure reported wages and tips and gross receipts for the current and prior two years.
 - c. If applicable, secure and review Form(s) 8027 from the NTRCP Analyst. If the form is not filed and the Property appears to be a required filer, discuss with the Property and secure the Form(s).
 - d. If the Property has not been compliant in all their filing requirements, contact the Group Manager and NTRCP Analyst before proceeding with the initial contact
 - e. See IRM 4.23.7.11, Mandatory Compliance Follow-Up Reviews on Voluntary Tip Agreements, for additional pre-contact analysis.

4.23.7.10.6.11
(05-10-2021)
**Initial Contact and Tour
of Business**

- (1) Schedule an appointment with the appropriate executive to meet at the Property for the interview and the tour of business.
- (2) **New Property:** Letter 3071, Tip Program Contact Letter, or Letter 5327, GITCA invitation, is used to contact and invite a new property into the Tip Compliance Program; properties have 14 days to respond to the letter
- (3) **Existing Property (established relationship):** The Reviewer will either issue Letter 5243, Rate Review Initial Contact Letter, or contact the Property by phone (the tip agreement contract establishes an ongoing relationship); Properties have 14 days to respond and commit to continue in the Tip Agreement Program process. Once an appointment is established, the Reviewer should

issue Letter 5243, Rate Review – Confirmation of Appointment, to confirm the date of the initial interview and follow the procedures below:

- a. Discuss importance of using a Project Team to complete templates
 - b. Review the benefits of the tip agreement
 - c. Explain the Streamline Method process
 - d. Document all actions on Form 9984, Examiner's Activity Log.
- (4) For large businesses, NTRCP utilizes the Memorandum of Understanding (MOU) – Agreement to Use Secure Email, to reduce taxpayer burden, cycle time, and costs associated with delivery from voluminous tip related financial data.
 - (5) The NTRCP is engaged in a process with SBSE Business Systems Planning, Security Program Management Office, to incorporate the Secure Enterprise Message System (SEMS).
 - (6) To E-Mail the following procedures must be used:
 - a. Memorandum of Understanding secured
 - b. Property identifies their employees to include in the MOU as participants
 - c. IRS identifies IRS employees to include in the MOU as participants
 - d. MOU approved by the Property and IRS
 - e. Current MOUs are effective indefinitely; however, many certificates expire after one year, and up-to-date certificates are required
 - f. MOU can be amended to add or remove employees
 - g. MOU will be retained in Las Vegas by the NTRCP Analyst
 - h. Digital certificates exchanged by all authorized employees for the Property and the IRS
 - i. Test messages are sent to ensure digital signatures were properly shared
 - j. Subject lines and attachment names will not be encrypted so IRS personnel must remain disclosure vigilant in these areas

4.23.7.10.6.12
(05-10-2021)
Initial Interview

- (1) The initial interview is used to inform the Property team about the Rate Review process including:
 - a. Confirm mutually agreed upon date to begin the Streamline Method process (within 30 to 60 days)
 - b. Prepares timeline based on the beginning and implementation date. The timeline serves as an opportunity to obtain taxpayer commitment to the process and to establish an estimated closure date
 - c. Arrange to conduct interviews with Administrative, FandB Manager(s) and Gaming Managers for each outlet
 - d. Determine a time period covered that will provide the most recent, completed financial data—A twelve-month period is always preferred in order to incorporate busy, slow, and average business seasons. Rates should never be calculated based on data selected only from the busiest or slowest times of year as that will not reflect a true average.
- (2) Tour of the business is required. The tour should be done both virtually and physically if possible. The virtual tour is completed during pre-audit or initial contact phases of the Rate Review. This will help the Reviewer determine the size and scope of the Rate Review. The Reviewer will create a Word document of the research completed or information obtained during a physical walk-through such as:

- a. Size and location (clientele)
 - b. Map of layout (as well a location of outlets, service bars, etc.)
 - c. Tipping Outlets
 - d. Types (Segregate by FandB; Front Services; Casino Floor; Guest Services
 - e. Hours of Operation
 - f. Menus
 - g. Press Releases (explanations of changes in operations)
- (3) There are multiple websites that may be consulted for additional information. See Employment Tax Tip/Gaming Training material ITM 28136-002, Catalog Number 53650W for more information on the pre-contact and initial contact with the Property. Meet with Property to conduct the tour of the business and conduct interviews with various departments to include but not limited to, Finance, Payroll, Human Resources, IT, and the Managers for all tipped outlets. See IRM 4.10.3.3, Interviews: Authority and Purpose, for authority and purpose for conducting interviews.
- (4) Interviews are used to develop information and establish facts. Interviews should always be held with the person(s) having the most knowledge of information needed. The topics that will enable the examiner to accomplish this goal should be outlined. Examples of information needed during initial interview include but are not limited to:
- a. Financial/Payroll/Human Resources/IT—the individuals from these areas are responsible for the implementation of the program at the Property; this group of individuals will handle the confirmation of compliance to the tracking of the tip rates in the payroll and time and attendance systems
 - b. The Managers of the specific outlets will discuss the details of the daily operations and provide Point of Sale (POS) data and staffing schedules; if the particular outlet has a rate of “ACTUAL” then the Manager must provide a copy of the Internal Control procedures

4.23.7.10.6.13
(05-10-2021)
**Information Document
Requests**

- (1) Develop Information Document Requests (IDR) to secure required payroll, financial and other supporting data for the selected time period covered. IDR should be tailored to the Property.
- (2) An initial, general IDR should be sent with the initial packet including the confirmation of appointment letter along with a copy of the MOU for Secure Email if applicable.
- (3) Additional IDRs are sent to request issue specific information needed to calculate tip rates or establish internal controls. A separate IDRs should be submitted for each topic, each outlet, and each recipient.
 - a. Point of Sales (POS) Reports; log of bell runs or occupancy information; number of tickets issued by valet; number of hands dealt for Poker—all information broken down by occupational category and shift if applicable
 - b. Payroll hours worked that are subject to tipping by outlet, occupational category and shift
 - c. Documents used to track and identify that there are adequate internal controls for outlets and occupational categories to be on “actual” rates. See IRM 4.23.7.10.6.17, Review of Internal Controls

4.23.7.10.6.14
(05-10-2021)
**Templates and
Parameters**

- (1) Reviewers will provide formula templates and instructions on how to complete the templates to the Property. See NTRCP Letters, Forms and Publications, for lists of formulas available on the repository.
- (2) Parameters, or subjective factors, determines the Cash Differential and Stiff Rate used in the templates. The Cash Differential is the difference between cash and charge tip rates. In general, the Cash Differential is usually between 1 percent-5 percent less than the charge tip rate depending on the type of restaurant, composition of tender and clientele. The Stiff Factor is referred to as a percentage of customers who leave no tip.

Note: The stiff factor is applied only to “cash receipts.” Cash receipts include receipts paid in cash, or charge receipts that did not leave a tip (comp sales are also treated as receipts paid in cash and may be subject to a cash differential and stiff factor). Charged receipts with a charged tip have a definite tip, so the stiff would not be applied to these receipts.

- (3) In the Streamline Method, the Property completes the template and provides requested documentation to the Reviewer to test the accuracy of the computation. Reviewers will request the basis for subjective factors if they don't meet the parameter guidelines. For example, ask the Property how the stiff rate was determined. If the basis does not appear reasonable, the Reviewer may need to develop additional observations to verify the accuracy of the subjective factors.
- (4) In the Traditional Method, the Reviewer completes the templates based on the information to complete the template (POS Reports, payroll information and notes from interviews).

Reminder: Comments should be made on your calculations to aid the Group Manager and/or Program Analysts in approval of rates. Examples are hours of operation, period of financial data, etc.

4.23.7.10.6.15
(05-10-2021)
Point of Sales Reports

- (1) Point of Sales systems used by Properties generate reports that provide details regarding revenue, including cash, credit card, comp sales, the breakdown of sales by job occupation, charge tip information, and product mix or breakdown of sales by menu item
- (2) Names of POS Reports vary dependent upon the system being utilized by the Property. Even if the Property does not have a common POS system, the general information needed can be requested and obtained from sales data.

(3)

Note: The *McQuatters* template requires a credit card sample. See Employment Tax Tip/Gaming Training material ITM 28136-002, Catalog Number 53650W for information on the templates, POS systems, and a credit card sample.

4.23.7.10.6.16
(05-10-2021)
**Payroll Requests and
Certification**

- (1) It is the responsibility of the Reviewer to test the capabilities of the payroll system and to verify that the property can track and apply the calculated tip rates accurately.

- (2) Staffing information and payroll reports provide details regarding hours worked by position for the period being reviewed. Reviewers will verify true “tipped hours” excluding administrative, vacation, or other non-tipped hours.
- (3) The Reviewer will test the payroll tracking system, documenting how the time and attendance system and payroll software system work to accurately apply the specified rate according to each outlet, occupational category and shifts.
- (4) The Reviewer must sample employees’ time and attendance cards or payroll records and verify the proper rates were used for each shift, occupation, and position to calculate the employees’ tax liability as reported on their paychecks.
- (5) The Reviewer will determine how Service Charges / Auto Gratuities / Contracted Charges / Bottle Charges (hereinafter “Service Charges”) are currently handled (or will be handled if a new Property or outlet). If Service Charges are not appropriately included as wages, the Property must be notified of the correct handling as discussed previously (Rev. Rul. 2012-18).
- (6) Only applicable to a GITCA agreement, if the Property can demonstrate tracking, applying and reporting the Participants rates , the Reviewer with managerial approval and NTRCP analyst concurrence may execute the Appendix E, Employer-Computed Tip Reporting Process Certification, certifying the Property’s payroll. If the taxpayer’s payroll is certified, the Property only must report the Non-Participants on the Year-End Report (Form 14439, Employee Data Report).

4.23.7.10.6.17
(05-10-2021)

Review of Internal Controls

- (1) The Reviewer must review the internal control procedures that are used to report tips to payroll, particularly in outlets that pool and split their tips (for example, pit dealers). Most of these types of outlets are on “Actual” rates, which means that the Property can capture 100 percent of the tips received because controls are in place that capture and report the actual tips earned through payroll.
- (2) The Reviewer will document the standard operating procedures from the inception of the tip received from the guest by the employee, to the placement of the tip in a designated toke box and eventually reported on a form supplied to payroll once the count and distribution is completed. Payroll then reports the tips on each employees’ checks. Forms should be requested, reviewed, and tracked for verification. Place documents given in the case file under appropriate section with other work papers.

4.23.7.10.6.18
(05-10-2021)

Analysis and Approval of Calculated Rates

- (1) Review the source documents to validate rate computations.
- (2) Check for reasonableness of the information. Test the staffing, charge, cash, and comp tip rates, number of drinks served, etc., for each template.
- (3) Verify the math/formula and accuracy of the computation. Errors do happen, even if the calculation was done on a pre-formulated calculation sheet. Use the most current rate calculation templates.
- (4) Request the basis for subjective factors.
- (5) If shift rates are applicable, validate the rate applies to the entire shift if the employee clocks in on one shift but also works hours for the shift that continues after the original shift. Does the same rate apply or would a different rate apply to the hours for each shift worked?

- (6) Once the information is verified as accurate and reasonable, and the subjective factors are within the parameters, the first level of approval would be the Group Manager, or Territory Tip Coordinator with permission from the Group Manager. If the subjective factors are **outside** the parameters, the calculations must be sent to a NTRCP Analyst for approval.
- (7) Set up a closing conference with the Property to discuss their approval of final rates and to provide a copy of the official document for listing the rates. Have the Property review the official list for errors, verifying that the outlets, occupational categories and shift titles are correct and lined up with the appropriate, corresponding rates.

4.23.7.10.6.19
(05-10-2021)
**Completion of
Agreement**

- (1) Reviewer will complete the official list of the rates and the agreement. The Reviewer will input the calculated rates into the Non-Participant Rates section. The Non- Participant rate is the audit standard. Next the Reviewer will apply a coverage adjustment to arrive at the Participant rate as recorded on the official document listing the rates.
- (2)) A coverage adjustment is an audit technique the IRS uses. It is a mathematical methodology to determine the tip rates for non-participants and participants. First, a calculation of the average tip rate is completed based on the Property's historical data. Once an average tip rate is determined, a coverage adjustment may be applied to the participant. A coverage adjustment is similar to the mathematical concept of a standard deviation. The purpose is to achieve a rate that encourages a majority participation and is based on the dispersion of customary tipping practices in different outlets for different services or transactions.
- (3) Items to be completed on the agreement include:
 - a. Property Information—Legal Information, Payroll EIN
 - b. Effective and Expiration Date
 - c. Signature Page—Name and Title of Signature Authority
 - d. Contacts Listing
- (4) Reviewer will prepare two copies of the agreement for signature once the rates are approved and will then forward to the Property for signing by the signature authority for the Property. Once the contract is signed by the Property, the contracts are returned to the Reviewer.
- (5) When the Reviewer receives the two originally signed contracts from the Property, the routing sheets are prepared (Form 14179, Form 14180, Form 14181) and the agreements are forwarded to NTRCP Program Manager for signature.
- (6) The NTRCP Program Manager reviews and signs (if concurs) both contracts and sends both signed copies of the contract to the NTRCP Analyst.
- (7) The NTRCP Analyst returns one original to Examiner and retains the other copy in the Las Vegas POD.
- (8) The original contract returned to the Examiner is copied for the case file and then forwarded to the Property for their records.

4.23.7.10.6.20
(05-10-2021)
Case Closing

- (1) After the Rate Review process is completed with the Property, the Reviewer will perform the following functions:
 - a. Copy the Agreement and prepare the case file for closure, see IRM 4.23.7.10.6.21, Case File Assembly, for more details
 - b. Forward the original agreement to the establishment with a copy of Letter 5724, Return Signed Document
 - c. Submit case file to SB/SE ET Group manager for closure
- (2) The SB/SE ET Group Manager will forward closed case files to:
Internal Revenue Service
Attn: NTRCP Program Analyst
110 City Parkway
Las Vegas, NV 89106

4.23.7.10.6.21
(05-10-2021)
Case File Assembly

- (1) Proper assembly of a case file helps minimize delays, administrative problems and procedural errors.
- (2) The forms, reports and/or other documents listed below are required in every case. While the list is not all inclusive, it addresses the most common items.
- (3) Attach the following to the face of the folder: Form 14179, GITCA Tip Agreement Routing Checksheet
- (4) Attach the following to the inside of the folder (stapled to the left side): Form 5345-NTRC
- (5) Workpaper Assembly: Unless instructed otherwise, Reviewers will use the NTRCP Employment Tax Lead Sheets developed specifically for the NTRCP cases. See IRM 4.23.7.10.6.6, Tip Review Employment Tax Lead Sheets, for details.

4.23.7.10.6.22
(05-10-2021)
GITCA Renewal Without Full Rate Review

- (1) A Reviewer can make a recommendation to renew an agreement without a full rate review if it is evident the participating Property is following the terms of their agreement, is not on comparable rates, has reported substantially all tip income and is in compliance with their payment and reporting responsibilities
- (2) To make this determination, the Reviewer will complete and document the following actions:
 - a. Review the current GITCA (e.g. addenda, prior extensions, economic rate reductions) to determine if renewal is appropriate
 - b. Perform IDRS research to confirm the Property's filing compliance
 - c. Perform Form 8027, Employer's Annual Information Return of Tip Income and Allocated Tips, analysis (per IRM 4.23.7.7.2, Employer Tip Examinations), if applicable, to determine if reported tips are reasonable. Review the current GITCA (e.g. addenda, prior extensions, economic rate reductions) to determine if renewal is appropriate
 - d. Review the GITCA Year-End reports filed by the taxpayer for the full-term of the current GITCA agreement. Compare a sample of the participant rates and hours with the tip income reported. If a Form 8027 is filed, also compare the volume and type of non-participants by outlet
 - e. Contact the designated Property's representative to secure insights from managers and/or employees to determine if the tip rates are appropriate

- f. Perform internet research and review the Property's website to identify new outlets, property expansion and changes in economic conditions, competition or ownership
 - g. Conduct a virtual walk-through of the business to reconcile the GITCA Appendix A/Attachment B to outlets observed on the Property's website
- (3) If the examiner determines the Property to be a candidate for GITCA renewal without a full rate review, the examiner will prepare and submit a recommendation containing a summary of findings to the Group Manager within 15 business days of making the determination. The recommendation will include a brief overview of the property, such as the size of the business along with the number of gaming features, restaurants and hotels at the establishment.
- (4) The Group Manager has 15 business days from the day the recommendation is received to review and forward the approved recommendation to the NTRCP Analyst with a copy to the Tip Coordinator. The NTRCP Analyst will consult with the Tip Coordinator, Group Manager and Reviewer as needed.
- (5) If the NTRCP Program Analyst concurs, the Analyst will forward the recommendation to the NTRCP Program Manager within 20 business days from the day they received the recommendation.
- (6) The NTRCP Program Manager is responsible for reviewing the summary findings and making the final decision whether to renew an agreement without a full rate review. In making this determination, the NTRCP Program Manager should consider the facts in the recommendation, as well as resource availability and workload needs.
 - a. If the NTRCP Program Manager determines the taxpayer is a candidate for GITCA renewal without a full rate review, such concurrence will be documented in the case file, and the examiner will be given approval to offer a GITCA renewal without a full rate review; Reviewers will follow procedures starting at IRM 4.23.7.10.6.19, Completion of Agreement.
 - b. If the NTRCP Program Manager determines the Property is not a candidate for GITCA renewal without a full rate review, the case file will be documented to indicate the basis for that determination; Reviewers will pursue a renewed GITCA, including a full rate review, following procedures starting at IRM 4.23.7.10.6.7, Rate Review Procedures.

4.23.7.11
(05-10-2021)
**Mandatory Compliance
Follow-Up Reviews on
Voluntary Tip
Agreements**

- (1) Securing the agreement is only the first step in increasing compliance for employers with employees who receive tip income. To ensure employers and their employees continue to report their tip income accurately, it is imperative that the IRS monitor the compliance level of the program participants. A unit consisting of workload identification examiners will monitor the various tip agreements as defined in this section.
- (2) Follow-up procedures for establishments participating in a TRAC, TRDA, GITCA, or EmTRAC agreement will include a review of the employer's Forms 941. If the program is working, an increase in the tip wages that are reported on Form 941 should be evident.
- (3) Under TRDA and GITCA, tip rates are established for the various worker categories in the establishment. These programs carry a threshold level of employee participation. Consistent with the terms of TRDA and GITCA agreements, at least seventy-five percent of the employees must sign an agreement

and agree to report at or above the established tip rate for their job category. NTRCP has developed lead sheets for performing compliance follow ups on TRDAs and GITCAs.

- (4) Generally, when an employer enters into a TRDA or GITCA, the employer agrees to review its tip rates, determine whether a tip rate increase/decrease is appropriate, and may submit proposed revisions to the IRS by a date specified in its agreement. The IRS Representative should follow up to verify whether any rate increases are required if the employer fails to contact the IRS by the specified date.
- (5) TRAC and EmTRAC do not require any tip rates to be established. However, employers do agree to educate new employees and re-educate continuing employees on a quarterly basis. TRAC also requires the employer to establish a reporting system and to file and pay taxes properly. There are specific lead sheets for performing compliance follow-up reviews. If you are assigned this work stream, contact an NTRCP Analyst for the most updated electronic version of these lead sheets.
- (6) Tip compliance agreements should be monitored at least annually. For TRAC, if the reporting of tip wages by tipped employees has not improved six months after securing the agreement, the employer should be notified. The IRS should correspond with the employer to remind them of their tip reporting obligations and the consequences for failing to comply with the agreement commitments.
- (7) Implementation of these follow-up procedures allows each employer to measure the effectiveness of their education program and determine whether the employees are complying with their tip reporting requirements. If noncompliance is identified, then examination referrals should be considered.
- (8) Time spent in performing compliance follow-up on agreement participating employers is applied to Activity Code "551." Use the following codes to document time spent on these compliance reviews:
 - MFT "C0"(C zero)
 - Source Code "99"
 - Project Code "1104"
 - Lead sheet will list tracking code for the specific market segment
- (9) A case file will be created when potential non-compliance is identified and will typically contain:
 - a. Forms 8027, Employer's Annual Information Return of Tip and Allocated Tips, for the current and prior two years
 - b. Annual and Quarterly Employee Reports
 - c. Employee Time and Attendance Reports
- (10) The compliance review will be assigned to an examiner to conduct the review which consists of the following phases:
 - Precontact Analysis
 - Taxpayer Contact
 - Compliance Review
 - Case Summary and Disposition

- (11) Precontact Analysis: Prior to contacting the taxpayer, the examiner will conduct and document a precontact analysis which will include some or all of the following:
- a. Review of the tip agreement, including any addenda, prior extensions and economic rate reductions to gain familiarity with the existing agreement.
 - b. Research the internet to determine if the taxpayer has any change in business ownership, locations, branding and/or types of business activities or workers.
 - c. Research IDRS to determine the taxpayer's filing and payment compliance and to secure reported wages and tips and gross receipts for the current and prior two years.

Analyze the information secured to determine if the current and two prior years of reported tips are reasonable and consistent. Following are some examples of situations where the analysis may indicate non-compliance with the tip agreement:

- a. Material change in sales, but minimal change in reported tips
 - b. Non-tippable sales on business tax returns not consistent with industry standards
 - c. Minimal change in sales, but material change in charged tips or number of employees on Forms 8027
 - d. Tip rate calculated using Form 8027 data is inconsistent with tip rates on current tip agreement
 - e. Discrepancies between Total Tips reported on Form 8027 and Total Medicare and Social Security Tip Wages reported on Form 941
 - f. Questionable allocation of tips on Form 8027
- (12) Taxpayer Contact: After completing the precontact analysis, the examiner will contact the taxpayer by letter to notify them of the compliance review. The letter will include an Information Document Request (IDR) to request only the necessary information applicable to each establishment to determine if the procedures and internal controls used to report both direct and indirect tips comply with the tip reporting requirements of the tip agreement. Examples of commonly requested records and documents include:
- a. Confirmation of the legal corporate name, d/b/a, physical address, individuals with signature authority (and title)
 - b. Name and EIN of entity filing Form 941 and Form W-2
 - c. Documentation of the program and materials used to educate new and existing employees about their tip reporting requirements
 - d. Written procedures requiring directly tipped and indirectly tipped employees to report tips
 - e. Documentation of the process used to ensure all reported tips are included on Forms 941 and Form W-2
 - f. List all establishments covered under the tip agreement
 - g. List of all tipped positions, tip rates, and number of tipped employees in each position
 - h. Policy and procedures for handling service charges and auto gratuities
 - i. List of systems used to track tips and prepare annual reports: point of sale, payroll, timekeeping, etc.
 - j. The examiner may contact the taxpayer by phone after 15 days to schedule an appointment for onsite visits, interviews, walkthrough of the tip reporting process, and review of IDR response

- (13) Compliance Review: The examiner may refer to the IRS training course number 28146-002, Combined Tip/Gaming Training, for guidance in conducting the compliance review. The course material also contains suggested analysis of Form 8027 data, samples to illustrate the process, and issues which may be encountered. The examiner will summarize findings and document interviews, tours taken (if any), three-year comparative analysis, overall tip reporting compliance analysis, etc. The case file workpapers must document review steps and include relevant supporting documents and records. The course material includes:
- a. Reviewing Internal Controls
 - b. Calculating Participation Level
 - c. Evaluating payroll procedures
 - d. Determining if tip agreement requires modification
 - e. Determining if the employer is complying with the tip agreement commitments
- (14) Fact patterns which may warrant revocation of the tip agreement include:
- a. The taxpayer has failed or refuses to establish and maintain an Employer-Computed Tip Reporting Process per Section V, paragraph J of the GITCA Tip Agreement
 - b. Analysis of GITCA or TRDA year-end reports indicates a substantial underreporting of tips for two consecutive years and or the taxpayer has failed or refuses to implement the procedures to timely and accurately report the required data.
 - c. A large food and beverage taxpayer's failure to file Forms 8027 for two or more years after NTRCP has sent them annual reminders via certified mail/return receipt.
 - d. Comparative analysis of three-years of tax return data shows stable gross sales and wages, but tips reported on Form 941 and or Form 8027 decreased substantially, and a review of external source information gathered through taxpayer contact indicates the business activity has not changed significantly.
- (15) Case Summary and Disposition: The examiner will prepare Form 14354, Summary of Compliance Review Findings and Recommendations, and forward the case file to the group manager for review and approval. The examiner must obtain managerial approval of the recommended disposition before notifying the taxpayer of the review outcome. There are three potential outcomes for a compliance review: no change, change and revocation.
- (16) Recommended "No Change" to tip agreement: The examiner will submit Form 14354 to the group manager for review and approval. After the group manager has approved the recommendation and documented the activity record in the case file, the examiner will notify the taxpayer of the results by issuing Form 14354. The examiner will close the case to the group manager within 15 days. The group manager will forward it to the NTRCP Analyst within 15 days.
- (17) Recommended "Change" to tip agreement: The examiner will prepare Form 14354-A, Compliance Review Acceptance Statement. The examiner will submit Form 14354 and Form 14354-A to the group manager for review and approval. After the group manager has approved the recommendation(s) and documented the case file activity record, the examiner will notify the taxpayer of the results by issuing Forms 14354 and 14354-A.

- a. If the taxpayer accepts the recommendations, signs and returns the Form 14354-A, and implements the necessary changes by the corrective action due date, the examiner will close the case to the group manager within 15 days.
 - b. If the taxpayer accepts the recommendations but is unable to implement the necessary change(s) by the corrective action due date, up to an additional 90 days may be granted with the group manager's approval. Group manager's approval must be documented in the case file. Form 14354 will be revised with the new corrective action due date. The examiner will reissue Form 14354 and Form 14354-A with the revised date and secure the taxpayer's signature. Place the case in suspense (status 15) and hold at the group until the response due date. The examiner will close the case to the group manager within 15 days of determining the corrective actions have been implemented.
 - c. If the taxpayer fails to address the corrective actions by the response due date or does not accept the recommendations, the examiner will recommend revocation of the tip agreement.
- (18) Recommended "Revocation" of tip agreement: The examiner will prepare Form 886-A, Explanation of Items, documenting deficiencies. The examiner will submit Form 14354 and Form 886-A to the group manager for review and approval. After the group manager has approved the recommendation and documented the activity record in the case file, the examiner will notify the taxpayer of the results by issuing Forms 14354 and Form 886-A. The examiner will offer the taxpayer an informal conference. If the taxpayer declines to participate or if there is no resolution from the informal conference, the examiner will close the case to the group manager within 15 days. The group manager will forward it to the NTRCP Analyst within 15 days to finalize the revocation.

4.23.7.12
(05-10-2021)
Petition for Lower Rate

- (1) IRC 6053(c)(3)(A) requires a large food and beverage employer to allocate tips among its tipped employees if the total tips reported to the employer during any payroll period are less than 8 percent (or the approved lower rate) of the establishment's gross receipts for that period. The amount to be allocated is generally the difference between the amount reported and the 8 percent. Certain receipts not ordinarily subject to tipping (known as non-allocable receipts) are not considered for this allocation. IRM 4.23.7.5, Information Return Reporting.
- (2) Rev. Proc. 86-21, 1986-1 C.B. 560, provides guidelines for employers and employees who wish to petition the IRS to have the percentage of gross receipts required to be allocated as tips reduced from 8 percent to a lower percentage (not below 2 percent). Petitions should be sent to the National Tip Reporting Compliance Program Manager. The address and instructions for requesting a reduction in the tip rate are provided in the Instructions for Form 8027, Employer's Annual Information Return of Tip Income and Allocated Tips. The Program Manager's secretary will forward the petition to the office where the taxpayer is located.
- (3) The petition must contain sufficient information to allow the IRS to estimate with reasonable accuracy the actual tip rate of the establishment. Burden of proof rests with the petitioner (taxpayer).
- (4) The user fee may change from year to year. The fee is posted in the first revenue procedure of each calendar year, e.g. for 2020 that would be Rev.

Proc. 2020-1. This revenue procedure is updated annually to reflect the new fee, posted under Appendix A. Since the petitioner is requesting a letter ruling determination, the payment for the user fee must be submitted along with the petition for the rate reduction.

- (5) This section provides guidelines to NTRCP field office personnel in determining whether the information submitted with rate reduction petitions supports the granting of such a reduction.
- (6) If the field office receives the user fee directly from the petitioner/taxpayer, Form 3244–A, Payment Posting Voucher - Examination, must be completed and forwarded with the user fee to the remittance processing area. The user fee and original Form 3244–A need to be transmitted no later than the next working day after receipt. Payments will be forwarded using Form 3210, Document Transmittal. Keep a copy of all the paperwork as evidence that a user fee was collected.
- (7) User fees are credited to the general fund revenue account and not to a taxpayer module. Do not enter a form number, MFT, or a tax period on the Form 3244–A, Payment Posting Voucher - Examination. The following must be included on the form:
 - a. SSN/EIN,
 - b. Transaction date (date user fee received),
 - c. Taxpayer name, address, and zip code,
 - d. Total user fees received,
 - e. In the “Remarks” section, write “USER FEE- DO NOT POST TO MASTER FILE,” and
 - f. Prepared by (name and symbols).

4.23.7.12.1 (12-18-2012) **Procedures for Tip Rate Reduction Petitions**

- (1) It is important to note that the information being reviewed is to be evaluated only in terms of granting a rate reduction below 8 percent and the burden of demonstrating the need for such a reduction is on the petitioner/taxpayer. This is strictly a discretionary area and mechanical formulas using point systems should not be used as the only criteria in making these determinations. Employment Tax personnel reviewing rate reduction petitions should not hesitate to request further information from the petitioner/taxpayer, if needed. If the reviewer is unfamiliar with the area or wants to observe the petitioner/taxpayer’s operation, a visit to the establishment should be considered.
- (2) If an examiner determines that a rate less than 8 percent is applicable, a determination letter must be sent to the taxpayer. Letters to be used for notifying the taxpayer are:
 - Letter 8027-A, Determination Letter for Approved Tip Allocation Rate Reduction - less than 10 Employees
 - Letter 8027-B, Determination Letter Approving Specified Lower Rate
 - Letter 8027-C, Determination Letter when Business Meets Cafeteria Style Establishment
 - Letter 8027-D, Tip Rate Reduction Request Denied

Generally, the period covered by the determination letter is not to exceed three years. At the end of this period, if the employer believes that the circumstances still warrant the use of an allocation percentage of less than eight percent, the employer will have to submit another petition.

- (3) Employers requesting tip rate reductions are required to submit certain information, as described in Rev. Proc. 86-21, if applicable, with their tip rate reduction request to the address given in the Instructions for Form 8027. Studies indicate that a tipping rate of 8 percent is low for most types of restaurants and bars, and the need for any reduction below 8 percent allocation rate must be fully supported by the information submitted.
- (4) The following are guidelines reviewers may use in evaluating tip rate reduction petitions (the sections refer to Rev. Proc. 86-21 sections).
 - a. Sections 3.01(a) through 3.01(c)(5), section 3.01(c)(7), and section 3.01(d) of Rev. Proc. 86-21 request a basic description of the establishment and its operations. This description gives information on items that can affect the tipping rate. In establishments where less than full table service is provided, such as self-service or cafeteria type of establishments, the tipping rate may be very low. Another major consideration is the establishment's location and type of clientele. Establishments near college campuses, for instance, may have mostly student customers who may tip at a lower rate. Other factors that may affect the tipping rate include rural versus urban location, full menu versus specialty (such as pizza parlors), and open for lunch only versus open for all meals.
 - b. Section 3.01(c)(6) requests financial information about the establishment that may be useful for determining the actual tip rate. For instance, the total sales subject to tipping can be computed by taking the gross sales and deducting carry-out sales and sales with a service charge. Dividing the total sales subject to tipping into the total tips reported to the employer by the employees will provide the tip rate reported by the employees. The total charge tips divided by the total charge receipts with charge tips may give a more reasonable estimate of the establishment's tip rate.
- (5) The Instructions for Form 8027, Employer's Annual Information Return of Tip Income and Allocated Tips give specific details on the information the taxpayer must submit with the written petition for the tip rate reduction. If the taxpayer has not submitted this information, contact the taxpayer and reference the Instructions for Form 8027 for the information that must be submitted.
- (6) The NTRCP Program Manager will assign the case to an NTRCP field group. The case will include a routing checksheet for processing the request.
- (7) Time for processing a tip rate reduction petition is applied to Activity Code "551" and Tracking Code "6451". The routing checksheet provides additional details.

4.23.7.13
(01-22-2010)
**Employment Tax
Monitoring Unit**

- (1) Employment Tax Operations will designate specialized resources to monitor the various employment tax programs. One of their duties will be to monitor the agreement inventory to ensure that employers and their employees continue to report their tip income accurately and that the agreement commitments are being satisfied. Follow-up procedures for establishments participating in a tip agreement include a review of the employer's Forms 941.
- (2) In general, monitoring the agreements should be done at least annually. If the employer has entered into a tip agreement that requires tip rates, these rates should be reviewed according to the agreement requirements. For GITCAs,

this may be every five years per Rev. Proc. 2020-47. A determination whether or not the rates should be adjusted will be made at that time.

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Exhibit 4.23.7-1 (05-10-2021)**Codes to Complete Form 5345-NTRC****MFT:** C0 (zero)**Source Code:** 99**Activity Code:** 551**Project Codes:** Required to identify the type of review. This information will be used to compile various data reports.

Project Codes	Definition
0985	Rate Reviews
0986	Addendums
1104	Compliance Reviews

Tracking Codes: Required to identify the type of business. This information will be used to compile various data reports.

Tracking Codes	Definition
6455	Hotels
6456	Valet
6457	Other Transportation Companies
7944	Casino (includes all venues owned by the casino)
7945	Racino
7946	Boats to Nowhere
7947	Restaurant (non-casino owned)
7948	Spa (non-casino owned)
7949	Golf Course
7950	Sky Caps
7951	Taxi
7952	Slot Bar
7953	Night Club
7954	Card Room
7955	Cosmetology
7956	Establishment - Initial Agreement (Comparable Rates)
7957	Agreement Enforcement Compliance Activities

Exhibit 4.23.7-1 (Cont. 1) (05-10-2021)**Codes to Complete Form 5345-NTRC**

Tracking Codes	Definition
7958	Other Tip Positions

Exhibit 4.23.7-2 (05-10-2021)

Chart of Tip Report Writing Instructions

If	Then	Issue Report	Issue Letter(s)
Tips is the only issue examined and there is no Section 3121(q) liability	Follow normal Employment Tax (ET) procedures. Prepare Form 4666* and issue Letter 3401-A, Employment Tax No Change Transmittal Letter, to transmit the RAR to the taxpayer	Form 4666*, Summary of Employment Tax Examination. See IRM 4.23.10.6, Notification Letters in No-Change or No-Liability Cases.	Letter 3401-A. In addition, undated Letter 3381, No Change Letter for Employment Taxes, is to be prepared in duplicate. Both copies are signed by the manager when closed from the group.
Tips is the only issue examined and a tip adjustment is warranted (there is a Section 3121(q) liability).	Prepare Form 4666*. Letter 3264, Pre-notice for Employer Share of Tax due on Unreported Tips with the report form.	Form 4666*. Special language goes on Form 4666. See IRM 4.23.7.7.3(6)	Letter 3264, Pre-notice for Employer Share of Tax due on Unreported Tips, sent with the Form 4666 and Letter 3263, Section 3121(q) Notice and Demand, will be issued at a later date.
Tips and other ET issues were examined and the tips were reported correctly (no Section 3121(q) liability), but adjustments made to other examined ET issues.	Examiner follows normal ET exam report procedures. See IRM 4.23.7.7.3(7)	Normal ET exam report procedures. See IRM 4.23.10, Employment Tax Report Writing Guide	Normal ET exam report procedures.
Other ET issues in addition to tips were examined, but adjustment is only to tips. There is a Section 3121(q) liability.	Prepare Form 4666 and issue Letter 4840, Unreported Tips and No Change for Other Examined Issues	Prepare Form 4666*. Special language goes on Form 4666. See IRM 4.23.7.7.3(7)	Letter 4840 notifies the TP that tips was the only issue that warranted adjustments and that no changes were proposed for the other examined issues. The letter also tells the TP that while there is no tax due for the year of examination, there is a tax liability due on the unreported tips. This tax is to be reported as a current period liability. See IRM 4.23.7.7.3(8)

Exhibit 4.23.7-2 (Cont. 1) (05-10-2021)
Chart of Tip Report Writing Instructions

If	Then	Issue Report	Issue Letter(s)
Tips and other ET issues were examined and all warranted an adjustment.	Prepare applicable employment tax RAR forms. Any tax attributable to the unreported tips will not be shown on the report because the tip adjustment is a current period liability.	Applicable Form 2504, Form 4666*, Form 4667, and Form 4668*. Special language must be entered on Form 4666*. See IRM 4.23.7.7.3(9)	Letter 4121E, Employment Tax Report Transmittal Letter, is used to transmit the RAR. Letter 3264, gives the taxpayer a brief overview of the process for reporting the additional tax and should include a detailed calculation of the additional taxes to be included in the Section 3121(q) Notice and Demand. See IRM 4.23.7.7.3(9)

Note: No dollar amounts pertaining to a Section 3121(q) tax are to be entered on Form 4666, Form 4668, or Form 2504 - represented by an asterisk (*) above. This is because a Section 3121(q) tax is treated as a current period liability and not subject to interest or deposit penalty if tax is paid timely by the taxpayer.

Exhibit 4.23.7-3 (05-10-2021) Letters, Publications, and Forms

Letters:

Letter Number	Letter Title	Catalog Number
Letter 3071	Tip Program Contact Letter	37178
Letter 3071-B	Tip Program Appointment Letter	37179
Letter 3263	Section 3121(q) Notice and Demand	28337
Letter 3263-A	Section 3121(q) Notice and Demand - Employer Only	52715
Letter 3264	Pre-Notice for Employer Share of Tax due on Unreported Tips	42098
Letter 3264-A	Employer Tip Adjustment Letter	42098
Letter 3265	Tip Program Follow-Up Letter	28339
Letter 3266	Employee Tip Adjustment	27340
Letter 3266-A	Employee Adjustment Letter	48224
Letter 3267	Delinquent 8027 Letter	28341
Letter 3269	Tip Program Application Receipt Acknowledgement Letter	37388
Letter 3346	Tip Program Participation Termination Letter	29295
Letter 3347	Tip Program Appreciation Letter	29296
Letter 3381	No Change Letter for Employment Taxes	29641
Letter 3413	Tip Program Non-Participation Letter	29541
Letter 4520	Section 3121(q) Notice and Demand	53994
Letter 4520-A	Closed- No Adjustments	58929

Exhibit 4.23.7-3 (Cont. 1) (05-10-2021)
Letters, Publications, and Forms

Letter Number	Letter Title	Catalog Number
Letter 4520-B	Tip Compliance Program Closed - No Adjustments	58930
Letter 4520-E	Form 4137 Tip Compliance Program - Extension to Respond to Letter 4520-P	58931
Letter 4520-F	Form 4137 Tip Compliance Program - Extension to Respond to Letter 4520	58932
Letter 4520-P	Pre-Notice for Employer Share of Tax Based on Form 4137	54015
Letter 4571-C	Year End Report - Non-Participants Only on GITCA	54535
Letter 4571-G	Year End Report - All Tipped Employees	54533
Letter 4571-T	Year End Report - Non-Participants Only on TRDA	54534
Letter 4639	Delinquent 8027 Letter (2)	55778
Letter 4640	Incomplete Form 8027	55779
Letter 4730	Compliance Review Appointment Notification	57855
Letter 4761	Agreement Request Denial	58087
Letter 4840	Unreported Tips and No Change for Other Examined Issues	58570
Letter 4879	Compliance Review Closing Letter	58350
Letter 4884	Non Participant Soft Notice (1st letter)	58857
Letter 5237	Tipped Employee Soft Notice Final Notice (3rd letter)	64042
Letter 5238-T	Second Request for Year End Data to Certified TRDA Establishments	64061
Letter 5238-C	Second Request for Year End Data to Certified GITCA Establishments	64060
Letter 5238-G	Second Request for Year End Data to Non-Certified GITCA Establishments	64063

Exhibit 4.23.7-3 (Cont. 2) (05-10-2021)
Letters, Publications, and Forms

Letter Number	Letter Title	Catalog Number
Letter 5243	Rate Review Initial Contact Letter	64066
Letter 5243-A	Rate Review - Confirmation of Appointment	67613
Letter 5243-B	Confirmation of Appointment - New Property	68649
Letter 5244	Soft Notice Follow-Up (2nd letter)	64075
Letter 5327	GITCA Invitation	64042
Letter 5445	4137 Unagreed Report - Cover Letter	66506
Letter 5575	Rate Reduction Ending Period	67896
Letter 5697	Document Signature Request	68372
Letter 5724	Return Signed Document	68439
Letter 5725	8027 Non-Filer Final Letter	68441
Letter 5873	Request of Secure Email MOU	69312
Letter 5874	GITCA Validation	69313
Letter 5874-A	TRDA Validation	69314
Letter 8027-A	Determination Letter for Approved Tip Allocation Rate Reduction - less than 10 Employees	52814
Letter 8027-B	Determination Letter Approving Specified Lower Rate	52815
Letter 8027-C	Determination Letter when Business Meets Cafeteria Style Establishment	52816
Letter 8027-D	Tip Rate Reduction Request Denied	52817

Publications:

Exhibit 4.23.7-3 (Cont. 3) (05-10-2021)
Letters, Publications, and Forms

Publication Number	Publication Title	Catalog Number
Pub 3114	Compliance Checks	26034
Pub 3144	Tips on Tips (A Guide to Tip Income Reporting) for Employer	26288
Pub 3144(BR)	Tips on Tips (A Guide to Tip Income Reporting) for Employer (Braille Version)	51078
Pub 3148	Tips on Tips (A Guide to Tip Income Reporting) for Employer (Large Print)	58191
Pub 3148(Tips on Tips (A Guide to Tip Income Reporting) for Employee	26307C
Pub 3148(SP)	Tips on Tips (A Guide to Tip Income Reporting) for Employee (Spanish)	27444Q
Pub 4902	Tax Tips for the Cosmetology and Barber Industry	56037
Pub 4902 (SP)	Tax Tips for the Cosmetology and Barber Industry (Spanish)	58889
Pub 4902 (VN)	Tax Tips for the Cosmetology and Barber Industry (Vietnamese)	58888
Pub 4904	How to Report Driver Referral Fees, Incentive Payments, and Other Income you Receive	57445
Pub 4932	Gaming Industry Tip Compliance Agreement (GITCA)	57822
Pub 4936	Your Guide to Maintaining and Complying with GITCA	57823
Pub 4985	Gaming Industry Tip Compliance Agreement - for Tipped Employees (Spanish)	59217
Pub 4985 (SP)	Gaming Industry Tip Compliance Agreement - for Tipped Employees	60743
Pub 5060	Employee Data Report Disk	60947
Pub 5080	Form 4137 Compliance Program Frequently Asked Questions	62616
Pub 5111	Gaming Industry Tip Compliance Agreement Benefit to Participants	65149
Pub 5112	Tip Rate Determination Agreement (TRDA) Benefits to Participants	65156
Pub 3374	Tips on Tips Video	27408Y
Pub 3742	Your Tax Responsibilities for Barber Instructors	31643V
Pub 3742-A	Your Tax Responsibilities for Barber Students	31644G

Forms:

Exhibit 4.23.7-3 (Cont. 4) (05-10-2021)
Letters, Publications, and Forms

Form Number	Form Title	Catalog Number
Form14179	GITCA Tip Agreement Routing Checksheet	55901
Form 14180	TRDA Tip Agreement Routing Checksheet	55902
Form 14181	GITCA Extension Routing Checksheet	55903
Form 14196	Filing Statement (not required to file F8027)	56047
Form 14354	Summary of Compliance Review Findings and Recommendations	58936
Form 14354-A	Compliance Review Acceptance Statement	58937
Form 14439	Employee Data Report	60879
Form 14515	Compliance Review Routing Checksheet	64056
Form 14516	TRAC Request Routing Checksheet	64057
Form 14532	Employee Non-Participant Data Form	58899
Form 14536	Baggage Handler	65418
Form 14537	Bell	65419
Form 14538	Bet Runners	65420
Form 14539	Bingo	65421
Form 14540	Cage	65422
Form 14541	Cashiers	65423
Form 14542	Change-Slot Floor	65425
Form 14543	Coat Check	65426
Form 14544	Keno	65427

Exhibit 4.23.7-3 (Cont. 5) (05-10-2021)
Letters, Publications, and Forms

Form Number	Form Title	Catalog Number
Form 14545	Limo-Shuttle	65428
Form 14546	Parimutuels	65429
Form 14547	Valet Parking	65431
Form 14548	Buffet - Gross Receipts Method	65434
Form 14548-A	Buffet - Number of Buffets Method	65435
Form 14548-B	Buffet - Number of Buffets (tip per cover)	66429
Form 14549	Combo Bar (Cash Charge Comp)	65436
Form 14549-A	Combo Bar (Cash Comp Only - NO CHARGE)	65437
Form 14549-B	Bar & Food (Cash and Comp)	66430
Form 14550	Comp Bars (Number of Drinks Method)	65438
Form 14550-A	Comp Bars (Sales Method)	65441
Form 14551	Multi Game Poker	65442
Form 14551-A	Poker No Tournaments	65444
Form 14551-B	Poker with Tournaments	65445
Form 14552	F&B McQuatters	65446
Form 145512-A	F&B McQuatters - Multiple Directly Tipped Positions	65448
Form 145512-B	McQuatters - Point System	65449
Form 14552-C	McQuatters - Multi Directly Tipped ees-tip out percent of sales	65450

Exhibit 4.23.7-3 (Cont. 6) (05-10-2021)
Letters, Publications, and Forms

Form Number	Form Title	Catalog Number
Form 14552-D	McQuatters - Multi Directly Tipped ees-tip out percent of tips	65451
Form 14552-E	McQuatters - tip out as a percent of sales	65452
Form 14552-F	McQuatters - tip out as a percent of tips	65454
Form 14553	Per Cover (Paid and Comp)	65462
Form 14553-A	Per Cover (Paid)	65465
Form 14553-B	Per Cover-Table Side Eating or Walk-up Counter	65466
Form 14553-C	Per Cup non-alcohol	65469
Form 14615	Tip Rate Reduction Request Routing Checksheet	66530
Form 14745	Application for TRAC	68615
Form 14789	SITCA	69503A
Form 14980	Employee Tip Examination Worksheet	38404
Form 14980-A	Explanation of Tip Income	68604
Form 14980-B	Computation of Tip Income Using the McQuatter's Formula	68605
Form 14980-C	FICA Tax and Penalty	68606
Form 14980-D	Summary of Employee Tip Examination Worksheets	68740
Form 5345-NTRC	Form 5345 NTRC	52469

