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IRS SIMPLIFIES TIP REPORTING AGREEMENT TO EASE BURDENS
ON RESTAURANT INDUSTRY, IMPROVE TAX COMPLIANCE

WASHINGTON – The Internal Revenue Service has taken steps to reduce administrative burdens on the restaurant industry by changing the Tip Reporting Alternative Commitment (TRAC) agreement.

In a major change, restaurant operators who follow IRS guidelines will no longer have their participation in the TRAC program jeopardized if their employees fail to accurately report tips. And the IRS has extended the TRAC program another five years – until May 2005 – because of its success in helping generate increased tip reporting by restaurant employees.

The IRS hopes these changes will encourage more restaurant participation in TRAC, a voluntary education program aimed at increasing tax compliance among restaurant employees and reducing the need for the IRS to pursue enforcement action.

Estimates have placed the amount of annual tips going to food and beverage industry workers at $18 billion or more annually. However, these employees reported $7 billion in tip income wages on their taxes in 1998.

Because of the large amount of unreported tip income, the IRS has embarked on several programs since 1993 to improve tax compliance. One of the major programs is TRAC, which started in 1995 as a joint effort between the IRS and the restaurant industry to educate workers about their tax obligations.

Employers entering into TRAC agree to:

Educate new employees and reeducate employees quarterly about their tip-reporting requirements.

Comply with all tax reporting, filing and payment obligations.

Maintain and make available records to the IRS.

(more)

Establish procedures under which employees report tips. Employees earning $20 or more a month in tips must report them to their employer.

In return, the IRS generally will not perform a tip examination on employers complying with the TRAC guidelines. In contrast, an establishment whose employees underreport their tips could be liable for back FICA taxes.

The approach has helped lead to increased tip reporting. In the food and beverage sector, tip reporting has jumped from $3.9 billion in 1993 to more than $7 billion in 1998.

The IRS has been working cooperatively with the restaurant industry on TRAC. In response to industry concerns, the IRS has made several TRAC changes, which are effective immediately:

The IRS will no longer revoke TRAC agreements in cases where employers make a good-faith effort at following the guidelines but employees still fail to report tips. Instead of pursuing the employers in such situations, the IRS will focus on the employees who are not in compliance with tip reporting.

Another change involves restaurants with locations in different IRS Districts. Under the new plan, the restaurant's headquarter operations will work directly with their local IRS office on TRAC issues. This streamlined approach will be simpler and more straightforward than the old system, where different locations of a company had to deal with different people in different IRS Districts.

The third change involves the expiration date of the TRAC program. Instead of ending in May 2000, the program will now run through May 2005 – with the possibility of it being extended even longer.

These changes will be reflected in the Internal Revenue Manual's Employment Tax Handbook. Specific details are included in the Handbook at three places: 104.6, Chapter 7, section 7.12.1.2; Section V. Revocation; and 104.6, Chapter 7, section 7.12.1.3.

Details about the changes will be mailed to current TRAC participants. About 10,000 companies – representing more than 30,000 locations -- have already entered the agreements, and the IRS hopes more will follow in the months ahead.

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