Office of Chief Counsel
Internal Revenue Service
Memorandum

Number: **201106009**
Release Date: 2/11/2011

CC:TEGE:EOEG:ET1:LLConway
POSTS-112862-10

UILC: 6041.00-00, 3121.00-00

date: April 28, 2010

to: John Tuzynski, Chief
(Supervisory Internal Revenue Agent)

from: Marie Cashman, Special Counsel
(Tax Exempt & Government Entities)

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subject: Payments to Taxi Drivers

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

This is response to your questions related to the proper treatment of amounts paid by certain establishments to taxicab drivers who deliver passengers. This advice may not be used or cited as precedent.

ISSUES

1. Whether the payments are income to the drivers.

2. Whether the payments are tips for services the drivers perform as employees of the taxicab companies or are payments for separate and distinct services.

3. What reporting requirements apply to the payments?

CONCLUSIONS

1. The payments to the drivers are income to the drivers.

2. Whether the payments are tips for services the drivers perform as employees of the taxicab company or are payments for separate and distinct services depends upon the specific facts and circumstances.

3. If the payments are tips, the drivers are responsible for reporting them to the taxicab company in accordance with I.R.C. § 6053(a). The taxicab company in turn must comply with the employment tax rules applicable to reported tips which include withholding, paying and reporting the applicable employment taxes and reporting the tips as wages on the Form W-2, Wage and Tax Statement. Alternatively, if the payments are for separate and distinct services, the establishments are responsible for complying with the reporting requirements under I.R.C. § 6041 with respect to such payments.

FACTS

The drivers are employees of taxicab companies that are engaged in the business of transporting passengers for a metered fare. The cabs are equipped with meters which calculate and display the fares for any transportation. The drivers pick up and transport passengers to their requested destinations. Typically, the driver collects the fares from the passengers, and the meter fare is split between the driver and the taxicab company. It is customary for the passengers to tip the drivers an amount in addition to the meter fare for the transportation provided.

Some establishments, including bars, restaurants and adult entertainment clubs, have a practice of paying amounts to taxicab drivers who bring passengers to their establishments. The payments may or may not bear any relationship to the meter fare, may vary depending upon the number of passengers, and may be far greater than either the metered fare or the customary tip for the transportation.[1] Typically, one or more passengers are transported from 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 a bar, restaurant or club, the hotel personnel will summon the driver's taxicab from the queue at the hotel, anticipating that the driver will split the payment from the establishment with the hotel personnel. In some cases the passenger may not request a particular destination and the driver or hotel personnel will recommend an establishment that will pay an amount for delivering the passenger.

Some taxicab companies have a Tip Rate Determination Agreement ("TRDA") with the Internal Revenue Service which sets forth agreed upon tip reporting requirements for the employees. A typical TRDA with a taxicab company requires a certain percentage of the meter fare to be reported by the driver to his employer as a tip. Under the terms of a TRDA, the employer must get 75% of the employees to sign employee participation agreements. TRDA participation assures the employer that periods covered by the TRDA will not be examined with respect to tips as long as participants comply with the requirements under the agreement. Participating employees who report their tips to their employer at or above the established tip rate will also not be audited with respect to tip income during the period the TRDA is in effect. With respect to non-participating employees and participating employees who fail to report at or above the

[1] We do not have sufficient facts to know whether the customary tip is still paid in these circumstances.

determined tip rate, the employer is required to provide to the IRS the names and social security numbers of those employees and amount of tips reported.

At present the establishments making the payments at issue are not reporting the payments to the individual drivers on a Form 1099, Miscellaneous Income, nor are the drivers reporting the payments to the taxicab companies as tips, such that the taxicab companies are not treating the payments as wages subject to employment taxes and required to be reported on Forms W-2. 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.

LAW AND ANALYSIS

Issue 1: Payments are income to drivers.

I.R.C. § 61(a)(1) provides that gross income means all income from whatever source derived, including (but not limited to) compensation for services, including fees, commissions, fringe benefits and similar items. Treas. Regs. § 1.61-2(a)(1) provides that tips are income to the recipients. The payments made by the establishments to the drivers are income to the drivers regardless of whether the payments are tips or remuneration for services that are separate and distinct from their employment by the taxicab companies.

Issue 2: Payments may be tips or payments for separate and distinct services, depending on facts and circumstances.

Small differences in the facts and circumstances may influence the determination of whether particular payments are tips for driving passengers as an employee of a taxicab company or payments for separate and distinct services.

Tips are not defined in the Code or regulations. However, published guidance is instructive in determining whether a payment is a tip. Rev. Rul. 59-252, 1959-2 C.B. 215, provides criteria which indicate when amounts received in an employment relationship are tips rather than service charges. The revenue ruling 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: (1) the payment must be made free from compulsion; (2) the customer must have unrestricted right to determine the amount thereof; (3) the payment should not be the subject of negotiation or dictated by employer policy; and (4) generally, the customer has the right to determine who receives the payment.[2] While the criteria listed in Rev. Rul. 59-252 are instructive, they were set out in the context of determining whether payments from a customer of the

[2] See also Rev. Rul. 57-397, 1957-2 C.B. 628 (holding that an amount automatically added to a hotel bill for disbursement to hotel employees is a service charge), and Rev. Rul. 69-28, 1969-1 C.B. 270 (concluding in various situations amounts received by employees were tips or nontip wages based on the facts and circumstances of the arrangement.)

employer were tips to the employees. Accordingly, application of the criteria is not necessarily determinative in all instances in classifying a payment as a tip in employment or as something else altogether. All of the surrounding facts and circumstances must be considered.[3]

On the question of whether the payments at issue are tips in employment or payments for separate and distinct services, certain facts and circumstances would support the characterization that the payments at issue are tips. For example, if the taxicab company shares in the payments made by the establishments and drivers are aware that they must turn over a portion of the payments to the taxicab company to keep their jobs, then there is a strong argument that the portion of the payments the drivers keep are tips as remuneration for driving the taxicab for the company. If the establishments all pay the same amount, and the passengers generally make clear that they want to go to a certain type of establishment, even if they do not request a specific destination, then the driver has no incentive to perform a service separate and apart from driving the passenger to any such establishment. If the passenger requests a particular destination, and the driver acquiesces without comment when he knows that the establishment will pay him for delivering the passenger, the payment looks more like a tip for performing only the transportation service the passenger requested.

Other facts and circumstances would support the characterization that the payments are for the drivers' separate and distinct services of delivering patrons to the establishments, rather than merely transporting the passengers as part of their duties for the taxicab company employers. If the driver recommends or selects the passenger's destination in order to secure the payment from a particular destination, then there is a strong argument that the establishment is paying the driver for bringing it customers, a service separate and apart from transporting the passenger in the taxicab. If the driver is collaborating with hotel personnel who have recommended or selected the destination, having agreed to share the establishment's payment with the hotel personnel, then there is also a strong argument that the driver is providing services that are separate and apart from driving the taxicab, that is, that of delivering patrons to certain establishments. If the passenger selects a particular destination, and the driver tries to persuade the passenger to go to a different destination because of the payment the driver can expect to receive, then there is once again a strong argument that the

[3] For example, a few court cases have used a test to analyze whether certain payments from patrons were "tips" includible in income or gifts excludable from income. Generally, the test used to determine whether or not the payments were "tips" rather than gifts is whether the payments were "an incident of the services provided". In Roberts v. Commissioner, 176 F.2d 221 (9th Cir. 1949), the Ninth Circuit, in considering whether tips to an employee taxi driver from customers were taxable income, recognized that tips "lacked the essential element of a gift,- namely, the free bestowing of a gratuity without consideration." *Id*. at 223. Furthermore, the court noted that "a tip is connected directly with the service and its quality." *Id*. at 224. The taxpayer "received tips as an incident to the service which he rendered to his patrons." *Id*. at 226. In Bevers v. Commissioner, 26 T.C. 1218 (1956), the Tax Court, relying primarily on Roberts, found that tokes (tips) were taxable income since the dealer received the monies as an incident of the services which he performed as an employee for the patrons.

driver is providing services that are separate and apart from driving passengers to their requested destinations.[4]

Issue 3: Reporting requirements apply whether the payments are tips or payments for separate and distinct services.

The reporting requirements applicable to the payments depend upon whether they are tips or payments for separate services under the facts and circumstances.

Social security and Medicare taxes under the FICA are imposed on employees and employers, I.R.C. § 3101 and § 3111, respectively, equal to a percentage of the wages received by an employee with respect to employment. I.R.C. § 3121(a) defines wages for purposes of the Federal Insurance Contributions Act (FICA) tax as all remuneration for services performed by an employee for an employer, with certain exceptions. Cash tips of $20 or more received by an employee in any calendar month in the course of the employee's employment by the employer, are wages for FICA purposes. I.R.C. § 3121(a)(12). Similar rules are provided with respect to income tax withholding. I.R.C. § 3401(f) and § 3402(k).

The Code establishes a set of specific rules that govern tip reporting. The fundamental rule is that an employee must report tips received to his employer. This rule found at I.R.C. § 6053(a) requires every employee who receives more than $20 in tips a month to report those tips to his employer on a written statement no later than the 10th day of the month following the month in which the employee received the tips. I.R.C. § 3121(q) and 3402(k) specify that tips are deemed to be paid at the time the employee furnishes the written statement required by I.R.C. § 6053(a). Thus, the employer's obligation to withhold and pay FICA and income taxes on tips does not begin until the employee reports tips to the employer. In addition, the employer is required to withhold and pay the employee's FICA and income tax on reported tips only to the extent that collections can be made from the employee's wages (under the employer's control, excluding tips) on or after the time the written statement is furnished. I.R.C. §§ 3102(c) and 3402(k).

If the employee does not report tips to his employer, the tips are considered to be paid at the time the employee receives them.[5] In the case of unreported tips, the employer is

[4] In fact, some of the drivers may be engaged in a separate trade or business of delivering patrons to the establishments. The U.S. Supreme Court stated in Commissioner v. Groetzinger, 480 U.S. 23, 36 (1987) that the question of whether a taxpayer is engaged in a trade or business requires an examination of the relevant facts in each case. Furthermore, to be engaged in a trade or business the taxpayer must be involved in the activity with continuity and regularity, and the taxpayer's primary purpose for engaging in the activity must be for income or profit. Id. at 36. While a determination that a driver has a separate trade or business of delivering patrons would even further indicate that the payments are made by the establishments in connection with such trade or business rather than as tips for the driver's employment, such determination is not critical to a finding that the payments are made for separate services by the driver.

not required to withhold and pay the employer portion of FICA on unreported tips until notice and demand for the taxes is made to the employer by the IRS. I.R.C. § 3121(q). The employee, however, remains liable for reporting these amounts in income in the year received and for paying the employee share of the FICA taxes.

I.R.C. § 6051(a) requires employers to provide employees with a written statement (currently Form W-2) each year showing, among other things, the amount of wages paid and the amount of income and employment taxes deducted and withheld. The statement must be furnished to the employee no later than January 31 of the year following the year in which the wages were paid. The deadline for filing Forms W-2 is the last day of February for paper returns and the last day of March for returns filed electronically. Under Treas. Regs. § 31.6051-1(a)(1)(vi), tips reported by the employee to the employer under § 6053(a) are reported as wages on Form W-2. Accordingly, if the payments at issue are tips, the usual rules governing tips apply. The employee must report the tips and the employer in turn must withhold and pay the applicable employment taxes and report the tips on Forms W-2. If the payments are tips, the establishment has no reporting obligation with respect to such payments.

If the facts and circumstances are such that a determination is made that the payments are tips, and the affected employer has a TRDA, consideration must be given to whether the payments that the employer's drivers receive from establishments to deliver passengers were taken into account in negotiating the percentage of the metered fare that must be reported as a tip under the TRDA. When an employer has a TRDA, the employer and participating employees are required to comply with the terms of the agreement. As mentioned above, participating employees are required to report tips of at least a specified percentage of receipts (the meter fare in the case of taxi drivers) and employers are required to follow the normal rules treating reported tips as wages subject to applicable employment taxes and reporting all reported tips as wages on the employees' Forms W-2. Thus, taxicab companies with a TRDA may take the position that they are in compliance with the TRDA. If the payments were not taken into account in negotiating the TRDA, the IRS should consider taking appropriate steps to address the affect of these payments, if any, on the TRDA.[6]

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[5] I.R.C. § 451(c) provides that tips reported as required by § 6053(a) are deemed received at the time the written statement is furnished to the employer.

[6] When faced with an IRS determination that the payments are tips, taxicab employers may disagree raising Rev. Ruls. 70-337, 1970-1 C.B. 191 and 70-331, 1970-1 C.B. 4, as authority that payments made to an employee by a third party (the establishment making the payments) that is not the common law employer are not wages. Non wage payments, are neither subject to employment taxes nor reportable on Form W-2. Rev. Rul. 70-337, holds that bonuses paid by a manufacturer to certain sales employees of its dealers, whether directly or though an agent (the dealer), are not remuneration for services performed for the dealer who employs the salesmen, but are remuneration for services rendered to the manufacturer and as such are not wages for employment tax purposes. The critical factor in this ruling was that the payments were for services performed for the manufacturer rather than the dealer. Similarly, Rev. Rul. 70-331, 1970-1 C.B. 4, holds that the fair market value of "prize points" redeemable for merchandise, awarded by a distributor to salesmen-employees of his dealers, is includible in the employees' gross income when it is constructively received, but is not wages for Federal employment tax

I.R.C. § 6041(a) 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 Service and to furnish an information statement to the payee. Treas. Reg. § 1.6041-1(c) provides that 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(a)(2) requires payments that are fixed or determinable to be reported on Form 1099. Regulations under I.R.C. § 6041 also address reporting related to certain payments to employees, providing that all wages paid to an employee that are subject to income tax withholding under I.R.C. § 3401 are required to be reported on Form W-2. In addition, all other payments of compensation from an employer to an employee in the course of the employer's trade or business must be reported on Form W-2, if the total of such payments and the amount of the employee's wages that are subject to income tax withholding total $600 or more in a calendar year. Treas. Regs. § 1.6041-2.

However, I.R.C. § 6041(e) provides that the reporting requirement contained in subsection (a) does not apply to tips with respect to which § 6053(a) (relating to reporting of employee tips) applies. I.R.C. § 6041(e) was added to the Code by § 501(b) of the Revenue Act of 1978 after the IRS had relied on Treas. Reg. § 1.6041(a)-2 as authority for the holding in Rev. Rul. 75-400, 1975-2 C.B. 464, as modified by Rev. Rul. 76-231, 1976-1 C.B. 378, to require employers to report on the employee's Form W-2 charged tips that the employer turned over to the employees, even though the employee had not reported those tips to the employer as required by I.R.C. § 6053(a).[7] Congress rejected the IRS attempt to require withholding on unreported tips and the Senate Committee explained:

> [R]equiring employers to report to the IRS charge account tips paid to employees on the basis of charge receipts (as sought to be imposed by Revenue Rulings 75-400 and 76-231) would place unnecessary recordkeeping and reporting burdens on the employer and would fail to provide the IRS with precise information on the amount of tip income taxable to particular employees. S. Rep. No. 95-1263, at 213 (1978).

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purposes. Relying on Rev. Rul. 70-337 the ruling concludes that the value of the prize points are not wages because the points are awarded for services rendered to the distributor. If there is an IRS determination that the payments are tips, we believe these rulings are distinguishable because the critical factor – performance of services for a third party - is missing. The driver is performing the services of driving and transporting passengers for the driver's common law employer, the taxicab company, and the payment from the establishment to the driver is a tip for the services performed for the common law employer. Thus, unlike the employees in the revenue rulings, the driver is not performing services directly for the third party.

[7] Tax Reform Act of 1976, § 2111, provided that the IRS was not to follow the rulings.

Thus, the enactment of I.R.C. § 6041(e) makes clear that the requirement to report tips paid in the course of an employment relationship is not imposed by I.R.C. § 6041(a).[8]

I.R.C. § 6721 provides for a penalty when an information return, such as Form 1099 or Form W-2, is not timely filed. The I.R.C. § 6721 penalty is waived if the failure to file the information returns is due to reasonable cause and not to willful neglect. I.R.C. § 6724(a). Treas. Reg. § 301.6724-1(a)(2) provides that the penalty for failure to file information returns is waived for reasonable cause only if the filer establishes that there are significant mitigating factors with respect to the failure (and that the filer acted in a responsible manner) or the failure arose from events beyond the filer's control. Significant mitigating factor include, but are not limited to-

> (1) The filer was never required to file this return or statement with respect to this type of transaction previously, or
> (2) The filer has an established history of complying with the information requirements with respect to this type of transaction.

Treas. Reg. § 301.6724-1(b). A filer acts in a responsible manner if the filer exercised reasonable care, undertook significant steps to avoid or mitigate the failure, and rectified the failure as promptly as possible once the impediment was removed or the failure discovered. Treas. Reg. § 301.6724-1(d). Whether or not the filer's actions were reasonable is an objective inquiry. Lefcourt v. United States, 125 F.3d 79, 84 (2d. Cir.1997).

If the payments at issue are for separate and distinct services of delivering patrons to the establishments, the establishments are required under I.R.C. § 6041 to file a Form 1099 with the IRS for each taxicab driver to whom they paid $600 or more during the calendar year.[9] If the establishments do not file Form 1099, whether they are subject to penalties under I.R.C. § 6721 depends on the facts and circumstances.

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[8] When an establishment makes payments for the delivery of passengers either to a nonemployee driver or to an employee driver performing a service that is not in the course of his employment with the common law employer, it cannot rely on § 6041(e) as authority for not reporting the payments to the drivers since such payments are not required to be reported under § 6053(a).

[9] If it is determined that the establishments are paying the taxicab companies, not the taxicab drivers, the establishments generally will not be required to file a Form 1099 because under current law the reporting requirement does not apply if the taxicab companies are corporations. But see, § 9006 of the Patient Protection and Affordable Care Act (PL. 111-148), enacted in March 2010, which requires information reporting for payments of $600 or more for property or services to a non-tax-exempt corporation after 2011.

Please call me at 202-622-6000 or Linda Conway at 202-622-0047 if you have any further questions.