

RESTAURANT & TIPPED EMPLOYEE PAYROLL GUIDE

Avoid the many pitfalls associated with tipped wages

Restaurant payroll is governed by complex laws for employee wages and tips. Restaurants pay several forms of wages with varying tax treatments, making legal compliance a challenge.

For example, a restaurant employee's paycheck may include regular wages, tips and gratuities, banquet tips, service charges, and meals – with the Internal Revenue Service (IRS) requiring employers to handle each of these categories in a particular way.

This report is a guide to all tipped wage earners such as:

- » Waiters and Waitresses
- » Bartenders
- » Valet
- » Taxi Drivers
- » Hairdressers & stylists
- » Doorman
- » Baristas etc

If you own a business that employs any of the above class of workers, this guide is for you.

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WHO IS A TIPPED EMPLOYEE?

According to the US Department of Labor, a tipped employee is an employee who receives more than \$30 per month in tips.

- » Tips are the property of the employee, regardless of whether or not the employer utilizes a tip credit.
- » The Internal Revenue Service (IRS) requires that employees record and report any tipped income of \$20 or more per month.
- » Employers may not use an employee's tips for any reason other than as a tip credit toward the minimum wage obligation.
- » An employer may only count the tips that an employee actually receives toward a tip credit.

Are automatic gratuities and service charges tips also?

Service charges or automatic gratuities are considered revenue for the restaurant, not tips for the employees. If these charges are distributed among the employees they are considered wages, not tipped income.

TIP ALLOCATION RULES AND REGULATIONS

As an employer, you must ensure that the total tip income reported to you during any pay period is, at a minimum, equal to 8% of your total receipts for that period.

In calculating 8% of total receipts, you do not include non-allocable receipts. Non-allocable receipts are defined as receipts for carry out sales and receipts with a service charge added of 10% or more.

If the reported amount of tips is less than 8% of the total food and beverage sales for the year, the employer must allocate additional tip income to the W2 of the tipped employees who reported less than 8% of their sales for the year.

There are three different methods for allocating employee tips:

THE HOURS WORKED METHOD

This is applicable to restaurants that employ less than 25 full time employees during a payroll period. This method allocates the tip shortfall (below 8% of total sales) by dispersing it between under-reporting employees based on their percentage of total hours worked in comparison to other employees. This method is not very accurate as it does not take into account different tipping patterns for different shifts.

THE GROSS RECEIPTS METHOD

This method can be utilized by any establishment, and generally results in a more accurate and fair allocation of tips. With this method, you allocate tips based on the percentage of gross receipts an employee earns compared to the total gross receipts for your business.

GOOD-FAITH AGREEMENT

You can allocate tips based on a good-faith agreement between you and your employees. This is a written agreement that explains how you will allocate tips among employees. You and two-thirds of employees in each occupational category who receive tips (e.g., waitstaff, bussers, bartenders) must accept the good-faith agreement.

The Instructions for Form 8027 provide the details of what should be in a good-faith agreement.

TIP POOLING RULES AND REGULATIONS

Tip pooling, also referred to as tip sharing, is an arrangement by tipped employees to aggregate their tips and then share accordingly. This arrangement is common with servers, bartenders, bussers, greeters and hosts (& hostesses) etc

Employer's responsibilities to govern tip pooling

- » The FLSA does not state a minimum or maximum contribution or percentage for tips pool.
- » Employers must determine and notify employees (verbally or in writing) of the required contribution amount.
- » Employers may only take a tip credit from the amount of tips the employee actually receives from the tip pool.
- » Only those tips that are greater than the amount of tips used for the tip credit may be taken for a tip pool.
- » Tip pools may not include employees who are not customarily tipped. Starting in March 2018, this has changed on the federal level. Tip pooling is now allowed between back and front of the house workers, as long as the tipped employees are paid full minimum wage. Some states are not in agreement.

TIP CREDIT RULES AND REGULATIONS

Tips are considered the employee's property, but under the FLSA guidelines, employers are allowed to count a percentage of the tips towards meeting the Federal minimum wage requirements. As of 2018 the federal minimum wage requirement is \$7.25 per hour.

Employer's responsibilities before using tip credit

The employer must provide the following information to a tipped employee before the employer may use the FLSA 3(m) tip credit:

- » Employers must inform tipped employees (verbally or in writing) of the cash amount of their direct wage.
- » Overtime must be calculated on the full minimum wage
- » If the tip credit does not meet the minimum wage requirements the employers must make up the difference
- » The additional amount claimed by the employer as a tip credit cannot exceed \$5.12 per hour. This is the difference between the minimum required cash wage of \$2.13 and the current minimum wage of \$7.25
- » The tip credit claimed by the employer cannot exceed the amount of tips actually received by the tipped employee
- » The employer cannot deduct from the employees' tip credit any walk-outs (unpaid meals), breakages (damages) or cash register shortages.
- » All tips received by the tipped employee are to be retained by the employee except for a valid tip pooling arrangement limited to employees who customarily and regularly receive tips
- » That the tip credit will not apply to any tipped employee unless the employee has been informed of these tip credit provisions.

State level regulations on using tip credit

As well as abiding to federal minimum wage laws, employers also must meet the state minimum wage requirements where they do business.

Employers in Alaska, California, Guam, Minnesota, Montana, Nevada, Oregon and Washington **are required to pay tipped employees full state minimum wage before tips.**

Employers in Arizona, Arkansas, Colorado, Connecticut, Delaware, the District of Columbia, Florida, Hawaii, Idaho, Illinois, Iowa, Maine, Maryland, Massachusetts, Michigan, Missouri, New Hampshire, New York, North Dakota, Ohio, Oklahoma, Pennsylvania, Rhode Island, South Dakota, Vermont, Wisconsin and West Virginia **mandate employers pay tipped employees above federal minimum wage.**

In Indiana, Kansas, Kentucky, Nebraska, New Jersey, New Mexico, Puerto Rico, Texas, Utah, Virginia, the Virgin Islands and Wyoming the cash wage is the same as that required under the FLSA. States that do not have minimum wages laws includes Alabama, Georgia, Louisiana, Mississippi, South Carolina and Tennessee.

RULES AND REGULATIONS FOR CREDIT CARD TIPS

For tips earned on credit cards, employers must pay the employee the tip no later than the next regular pay day. Employers cannot hold the tip until they receive the money from the credit card company.

According to the FLSA the employer can deduct the cost of the transaction fee for the amount of the tip. However, there are some states that completely forbid this practice. States that prohibit deducting credit card processing fees from tips include California, Maine, and Massachusetts.

States that do not have laws prohibiting deducting fees, but have ruled "tips are the property of the employee" include Kentucky, Montana, and Colorado. In Colorado, if credit card fees are deducted from tips paid the employee, the employer might not be able to claim the employee tip credit.

States where deducting processing fees is permitted by law include Minnesota, New York, North Carolina, Utah, and Vermont.

RULES AND REGULATIONS FOR TAXES ON TIPS

According to The Equity and Fiscal Responsibility Act (TERFA) and Tip Reporting and Alternative Commitment (TRAC), employees who earn more than \$20 per calendar month are required to have their tips taxed.

Employers are required to collect and pay taxes on employees reported tips. These taxes include federal and state personal income tax withholding, federal and state unemployment insurance, state local and disability taxes, and Social Security and Medicare taxes.

The IRS mandates tipped employees record and report 100% of tipped income of \$20 or more in a calendar month. Employees are also required to report the cash value of non-cash tips. Tip amounts are due by the 10th of the following month of which the tips were received. Even though these reports are only due once a month, employers should collect this report at the end of every pay period. IRS Publication 1244 includes instructions and forms for this purpose.

In addition to correctly withholding and paying payroll taxes on tips, restaurant employers are also required to file IRS Form 8027 at the end of every year. It is important to note the total amount of tips reported by the employees must reflect a minimum of 8% of the restaurant's total gross receipts for food and beverage for the year.

Taxes on Allocated Tips

Income taxes are not withheld from allocated tips. Instead, employees will use Form 4137 to calculate their Social Security and Medicare taxes.

However, with regular tip income received directly from customers, you must withhold taxes, including federal income tax, Social Security tax, and Medicare tax.

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