

## Prudent Tips on Withholding

If your employees regularly receive tips, it is important to comply with the withholding requirements and pay your company's fair share of employment taxes. Expensive penalties can be assessed on both employers and employees if the tip reporting rules are not followed.

Here's a brief summary of some of the requirements for federal income tax and FICA (Social Security and Medicare) withholding, as well as filing.

### Income Tax Withholding

You're required to withhold federal income tax on an employee's cash tips of \$20 or more per month. The employee is generally supposed to report the tips to you by the tenth day of the month following the month of receipt.

Your company can elect to treat tips as supplemental wages. The tips can be reported in the regular payroll amount or subject to withholding at a flat rate of 25 percent.

### FICA Withholding

If the employee's cash tips do not exceed \$20 in a calendar quarter, there is no FICA tax liability. However, any excess is subject to FICA. The same general rules apply to tips as wages. For instance, the Social Security portion of the tax applies to an annual "wage base" \$118,500 for 2015. The 1.45 percent Medicare portion of the tax applies to all wages.

The employee's share of Social Security tax is 6.2 percent and the Medicare portion is 1.45 percent. The same is true for the employer share of these two taxes.

If you run a food or beverage establishment, you may be able to defray part of the cost of FICA through a special tax credit. Ask your payroll tax adviser if you are eligible for the 45B Credit, named for the section of the tax code it comes from.

Note: Reported tips are also subject to federal unemployment tax (FUTA). There are no income limits. These withholding rules require the employer to collect income tax and FICA on reported tips unless the employee provides the necessary funds. If you can't deduct the full amount from the employee's regular wages - and the employee doesn't otherwise provide the funds -- the tax must be paid directly with the employee's tax return. If you can collect only part of the amount due, apply what you collected first to FICA.

### Filing Requirement

A business is generally required to file Form 8027, *Employer's Annual Information Return of Tip Income and Allocated Tips*, for each establishment if:

- Food or beverage is provided for consumption on the premises.
- Tipping is a customary practice.
- More than ten full-time employees are employed on a typical business day. The term "employee" isn't limited to waiters and waitresses. It comprises everyone on the payroll, from cooks to dishwashers to musicians.

**Caution:** Employees who don't follow these tip reporting rules may be hit with a penalty equal to 50 percent of the FICA tax due in addition to paying the employer's share of the tax.

### Tell Employees Why They Should Report Tips

The IRS provides the following points employers can make to employees who are reluctant to report their full amount of tips. In the long run, it's beneficial to report all tips because:

1. Tip reporting increases Social Security credits, which maximizes benefits at retirement.
2. It can make the employees eligible for higher amounts of unemployment benefits and Workers' Compensation.
3. It may increase the chance of receiving financing for a home, car, or other necessities.