

Topic no. 761, Tips – withholding and reporting

Employees who receive cash tips of \$20 or more in a calendar month while working for you, are required to report to you the total amount of tips they receive. The employees must give you written reports by the tenth day of the following month. Employees who receive tips of less than \$20 in a calendar month aren't required to report their tips to you but must report these amounts as income on their tax returns and pay taxes, if any.

Cash tips include tips received directly from customers, tips from other employees under any tip-sharing arrangement, and charged tips (for example, credit and debit card charges) that you distribute to the employee. Both directly and indirectly tipped employees must report tips received to their employer.

Service charges added to a bill or fixed by the employer that the customer must pay, when paid to an employee, won't constitute a tip but rather constitute non-tip wages. These non-tip wages are subject to Social Security tax, Medicare tax and federal income tax withholding. In addition, the employer can't use these non-tip wages when computing the credit available to employers under section 45B of the Internal Revenue Code, because these amounts aren't tips. Common **examples of service charges** (sometimes called auto-gratuities) in service industries are:

- Large party charge (restaurant),
- Bottle service charge (restaurant and night-club),
- Room service charge (hotel and resort),
- Contracted luggage assistance charge (hotel and resort), and
- Mandated delivery charge (pizza or other retail deliveries).

Recordkeeping

Employees can find information in [Publication 531, Reporting Tip Income](#) under “How to keep a daily tip record.” You may also provide other means for your employees to report tips to you, for example, a system for electronic tip reporting by employees.

Withholding taxes

When you receive the tip report from your employee, use it to figure the amount of Social Security, Medicare and income taxes to withhold for the pay period on both wages and reported tips. You're responsible for paying the employer's portion of the Social Security and Medicare taxes.

Additional Medicare tax applies to an individual's Medicare wages that exceed a threshold amount based on the taxpayer's filing status. Employers are responsible for withholding the 0.9% Additional Medicare tax on an individual's wages paid in excess of \$200,000 in a calendar year, without regard to filing status. An employer is required to begin withholding Additional Medicare tax in the pay period in which it pays wages in excess of \$200,000 to an employee and continue to withhold it each pay period until the end of the calendar year. There's no employer match for Additional Medicare tax. For more information, see the [Instructions for Form 8959](#) and [Questions and Answers for the Additional Medicare tax](#).

You collect the employee's portion of these taxes from the wages you pay your employee, or from funds the employee gives you. If you don't have enough money from the employee's wages and funds your employee gives you, withhold taxes in the following order:

1. All taxes on the employee's wages (exclusive of tips),
2. Social Security, Medicare, Additional Medicare on the employee's reported tips, and
3. Federal, state, and local income taxes on the employee's reported tips.

Withhold any remaining unpaid federal income taxes from the employee's next paycheck, up to the close of the calendar year. However, if you can't collect all of the employee's Social Security and Medicare taxes on tips by the 10th day of the month following the month in which your employee reported the tips, you don't have to collect these taxes. Show the uncollected amount as an adjustment on your employment tax return (for example, [Form 941, Employer's QUARTERLY Federal Tax Return](#)). Also, be sure to report the uncollected Social Security and Medicare taxes in the appropriate box on the employee's [Form W-2, Wage and Tax Statement](#), but don't show any uncollected Additional Medicare tax on Form W-2. You may want to inform your tipped employees that if all the federal income taxes and Additional Medicare tax on their wages and tips won't be collected by the end of the year, they may need to make estimated tax payments. If an employee doesn't pay enough tax throughout the year, either through withholding or by making estimated tax payments, the employees may be subject to a penalty for underpayment of estimated taxes. Refer your employees to [Publication 505, Tax Withholding and Estimated Tax](#) for additional information.

When preparing an employee's Form W-2, include wages, tips, and other compensation in the box labeled "Wages, tips, other compensation." Include Medicare wages and tips, and Social Security tips in their respective boxes. When figuring the employer's liability for federal unemployment tax, add the reported tips to the employee's wages.

Allocated tips

If you operate a large food or beverage establishment, you must file [Form 8027, Employer's Annual Information Return of Tip Income and Allocated Tips](#) for each calendar year and may be required to allocate tips to your employees. You operate a large food or beverage establishment if tipping is customary, you provide food or beverages for consumption on the premises, and you normally employ more than ten people who collectively work more than an average of 80 hours on a typical business day. If you have more than one large food or beverage establishment, you must file a separate Form 8027 for each establishment. Form 8027 is due on the last day of February of the next year (March 31 if filing electronically). If you meet the criteria for filing Form 8027 but don't file, the law provides for penalties for each failure to timely file a correct information return, including failure to file electronically, if required.

If the total tips reported by all employees at your large food or beverage establishment are less than 8 percent of your gross receipts (or a lower rate approved by the IRS), you must allocate the difference between the actual tip income reported and 8 percent of gross receipts among the employees who received tips. You may base the allocation on each employee's share of gross receipts or share of total hours worked, or on a written agreement between you and your employees. You're required to report the amount allocated on Form W-2 in the box labeled "Allocated Tips" for each employee to whom you allocated tips. Penalties may be imposed for both failing to file and failing to furnish a correct Form W-2 on which you fail to include this required information. Don't withhold income, Social Security, Medicare, Additional Medicare, or railroad retirement taxes on allocated tips, since your employee didn't report these amounts to you.

Whether or not you're required to allocate tips, your employees must continue to report all tips to you, and you must use the amounts they report to figure payroll taxes.

Tip Rate Determination and Education Program

The Tip Rate Determination and Education Program (TRD/EP) was designed by the IRS to enhance tax compliance through educational programs and the use of voluntary tip reporting agreements instead of traditional audit techniques. Tip reporting programs improve tip income reporting by helping taxpayers to understand and meet their tip reporting responsibilities and offer many benefits for the employer and the employee. The Service Industry Tip Compliance Agreement (SITCA) program has recently been proposed to replace two of TRD/EP's existing tip reporting programs, the Tip Rate Determination Agreement (TRDA) and the Tip Reporting Alternative Commitment (TRAC). SITCA would be available to employers in all service industries except the gaming industry employers. The Gaming Industry Tip Compliance Agreement (GITCA) program is available to employers in the gaming (casino) industry. For more information about GITCA, TRDA, or TRAC programs, see [Publication 3144, Tips on Tips \(A Guide to Tip Income Reporting for Employers in Businesses Where Tip Income is Customary\)](#) [PDF](#).

Additional information

For more information, refer to [Publication 15 \(Circular E\), Employer's Tax Guide](#). Also, [Revenue Ruling 2012-18](#) provides guidance for employers and employees in a question-and-answer format regarding Social Security and Medicare taxes imposed on tips, including information on the difference between tips and service charges, the reporting of the employer share of Social Security and Medicare taxes under section 3121(q), and the section 45B credit.

Page Last Reviewed or Updated: 26-Jun-2025