

The IRS is back with tip audits! Do your employees know what to report as tip income? If they think it's 8% of receipts... they're wrong!

IRS wins again. Score: 3-2!

The Seventh Circuit Court has held that "the IRS has the authority to assess the employer share of FICA tax on the unreported tips of employees on an aggregate basis without first assessing against individual employees."

330 West Hubbard Restaurant operated the Coco Pazzo restaurant in Chicago. Coco Pazzo declared to the IRS both its charge tips and total reported by employees. It reported combined charge tips for 1993, 1994, and 1995 of \$1,412,786. For those same years, Coco Pazzo employees reported total tips of \$450,837.

It was obvious to the IRS that the employees had underreported their tips by at least \$961,949. Other information enabled the IRS to determine the precise amount that the employees underreported was \$1,112,454. Based on this, the IRS determined that Coco Pazzo owed employer FICA of \$85,104.



Coco Pazzo argued that before the IRS could assess the employer share of FICA tax on unreported tip income of individual employees, it had to first assess the unreported tip income of individual employees. They also argued that "the Social Security earnings records of individual employees are not credited and therefore the company is paying for non-existent benefits."

The court agreed with the IRS. It said the fact that employees do not receive earnings credit is not due to the IRS's method of assessment. If Coco Pazzo's employees do not receive credit, it is their own fault. The 50 employees whose Social Security earnings records will not be credited should have reported all of their tips in the first place.

Note: The IRS has lost in District Courts in California and in Florida. They have won in the Seventh, Eleventh and Federal Circuit Courts.

How do employees benefit from reporting all tips?

1. They avoid IRS penalties and interest if audited and the IRS finds they underreported income.
2. They will receive social security benefits when they retire based on their total income, which includes reported tips.

3. Their applications for mortgages and other loans will take their entire reported income into consideration.

What **are** employees supposed to report?

The law has always been that tipped employees are supposed to report 100% of the tips they receive.

The IRS web site (www.irs.gov) says "All tips you receive are subject to federal income tax. You must include in gross income all tips you receive directly from customers, tips from charge customers that are paid to you by your employer, and your share of any tips you receive under a tip-splitting arrangement."

Why do so many employees (and employers) think it's only 8% of receipts that need to be reported?

In the early 1980s, the IRS decided that tipped employees were underreporting their tipped income.

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Important reminder for end-of-quarter

– Remember to process **end of month/quarter** at the end of each quarter, so your new quarter figures will be accurate.

Tip Reporting continued from page 1

Rather than go after individual tipped employees, they got a law passed that put the burden on the employer. In effect, that law states that if the employees working for a “large food & beverage establishment” as a group report tips that amount to less than 8% of total receipts for any calendar year, the employer is responsible for telling the IRS (1) that they reported less than 8%, and (2) how much each employee’s share of the shortfall is. This is reported on the employee’s W-2 and

The IRS is back! No more self-imposed moratorium on tip audits.

also on the Form 8027 filed by each establishment of each company.

Because the allocation threshold is 8%, many people think that 8% of receipts is all that food and beverage tipped employees have to report and pay taxes on. That is incorrect. It’s 100% of tip money (cash or charge) that the employee receives.

What does the IRS consider a “large” food or beverage establishment?

According to the Circular E (Employer’s Tax Guide), “A large food or beverage establishment is one that provides food or beverages for consumption on the premises, where tipping is customary, and where there are normally more than 10 employees on a typical business day during the preceding year.” That’s 10 employees for the day, not the shift, and it includes all employees, not just tipped employees.

Does tip reporting apply to other tipped industries, such as hair salons, parking garages, taxi firms, and car washes?

Tip *reporting* applies to **all** tipped industries – their tipped employees are required to report 100% of the tips they receive. However, tip *allocation* is required only of food and beverage establishments that fall within the IRS’ definition of “large.”

Audits to begin for taxi firms, car washes, hair salons, and restaurants.

The IRS is back! They are lifting their self-imposed moratorium on tip audits and will be auditing restaurants, taxi firms, car washes, and hair salons.

If your industry is one being targeted for audits, you might want to check out the Market

Segment Understandings (MSU) that the IRS has developed for the hairstyling, gaming, and food service industries. The text is available on the IRS web site (search for MSU or Market Segment Understandings).

Market Segment Understandings (MSU)

The IRS’s Market Segment Understanding Program, first introduced in 1993, is (according to their Web site) “a means of enhancing tax compliance while reducing taxpayer burden. This Program envisions that the IRS and taxpayers in particular market segments work together to improve tax compliance in those areas through educational efforts and other collaborative approaches rather than through traditional audit techniques.”

“The IRS, in a continuing effort to increase tax compliance and at the same time reduce taxpayer burden, has expanded its MSU Program into

other industries. The newest additions are a Tip Reporting Alternative Commitment (TRAC) for use in the Hairstyling Industry and the Tip Rate Determination Agreement (TRDA) for use in the Gaming Industry. Other Market Segments



Understandings include the Tip Reporting Alternative Commitment (TRAC) for the Food Service Industry.”

The TRAC for the food service industry replaces the earlier TRDA. If an employer signed a TRDA (Tip Rate Determination Agreement) with the IRS, that agreement supercedes the tip reporting requirements mentioned here. With a TRDA in effect, employees of that restaurant don’t report tips. Instead the employer reports the tips for each employee at the percentage stated in the TRDA, whether the employee actually received that amount or not.

If the employer signed a TRAC (Tip Reporting Alternative Commitment), the employees continue to report their tips. The TRAC requires the employer to agree to educate new and current employees, on a continuing basis, about correct tip reporting. It also requires employers to provide a written record of charge tips to each employee monthly, and to give them the opportunity to correct the records to reflect tip outs and tip sharing.

Spend some time researching what’s going on, so you’re ready when the IRS appears on your doorstep. Many of the Market Segment Specialization Program Audit Technique Guides used by IRS auditors are available on the IRS Web site www.irs.gov/prod/bus_info/mssp/index.html.



Tax law changes

Effective dates, if known, are noted.

Federal

■ IRS Tip Audits

The IRS self-imposed moratorium on tip audits is ended based on the fact that three federal circuit courts of appeal have found that the IRS has the authority to assess employer FICA taxes on tip income without first examining the tip records of individual employees. However, the announcement states that employer-only FICA assessments will be made "only in the most extreme cases of noncompliance." (IRS Announcements 2000-19 and 2000-23).

■ W-2 changes coming in 2001

Effective for tax year 2001 (for forms to be filed in 2002) there will be a new design for Forms W-2 and W-3 to facilitate scanning. Width will increase to 8.5 inches, and all boxes will be widened.

Other changes not related to scanning issues will also be made. These include the elimination of Box 12 (benefits included in Box 1), the renumbering of subsequent boxes, the deletion of the "Deceased," "Legal rep" and "Deferred compensation" checkboxes and, the addition of a "Third-Party sick pay" checkbox.

State disability

CA SDI rate increased from .5% to .7% effective 4/1/00.

State minimum wage

CT Effective 1/1/01, increases to \$6.40/hour. 1/1/02 increases to \$6.70/hour. Effective 1/1/01 through 12/31/02, tipped employees (except bartenders) rate will be \$4.74. For bartenders who regularly receive tips, minimum wage is \$6.15.

NY Increased to \$5.15/hour effective 3/31/00. The minimum wage for food service workers, which was originally supposed to increase to \$3.80/hour instead was increased to \$3.30/hour. Tips added to cash wage must equal or exceed the \$5.15 minimum. Technically, these new tip allowances became effective 3/31/00.

New tip allowances for workers others than food service workers and meal, lodging and uniform allowances will be included in new wage orders. Because the Department of Labor was not able to release the accurate figures on that date, employers will be given a two-month grace period for implementing the new allowances.

State unemployment

VI 1/1/00, taxable wage base increases from \$14,600 to \$15,900.

WA Taxable wage base originally announced as \$26,500 for 2000 has been lowered to \$24,300, its 1999 amount.

WI Effective 1st quarter 2001, employers with 100 or more employees must file quarterly wage reports using electronic or magnetic media.

State withholding

DE New withholding tables 1/1/00.

ID Withholding limits on garnishments for consumer credit sales have been reduced to the lesser of 25% of disposable income or the amount over 30 times minimum wage.

MI City of Battle Creek personal exemption is \$1,500 effective 1/1/00.

MN Bill signed reducing income tax rates. No announcement has been made about changing the withholding tables.

NY NY City non-resident earnings tax has been eliminated retroactively effective 7/1/99.



THE BLUE PAGES

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Special Q&A on Void & Select Checks

Q. When I void a check and then reissue it with a select check, how do I get the correct FTD amount?

A. As long as you haven't processed end of month after voiding the check and reissuing it, you can include voids and selects on the pre-check register of your next regular payroll. Respond **Y** when asked **Include void checks in register totals/tax deposit report?** and **Include select checks in register totals/ tax deposit report?**

The void check register and the select check register print first, with the checks that were voided and the select checks issued included on the Totals Page of the pre-check register and on the FTD report. These checks will also be on your Schedule B.

Responding **N** to the above *PayMaster*TM prompts means void and select checks will **not** be included with the next payroll for purposes of the Totals Page or the FTD report, and will not be on the Schedule B. You can then use the FTD reports (add the void and select together) to make a separate FTD deposit and manually enter the amount in *PayMaster's* Schedule B. To do this, go to REPORTS/941/DAILY LIABILITY and select the appropriate quarter. Position the cursor on the correct date and enter the amount.

If the void and select check FTDs added together are a negative amount, you can subtract it from your next FTD. Or if it's a different quarter, ask for a refund of the excess payment or apply it

to the next quarter when you file your 941.

Note: Don't forget about state, local, and SDI tax deposit amounts being affected by void and select checks.

Q. How do I get correct figures for my general ledger when I have voids and selects?

A. The easiest way is to print a general ledger report for the month-to-date. All regular pay period payrolls, as well as all voids and selects (since you last processed end of month) will automatically be in the totals. Go to PROCESS/ PAYROLL INTERFACE and select <2> MTD from the POST menu. Print the GL transaction register (no need to create the GL interface file unless you're interfacing to your GL program).

If you have been posting to the general ledger each pay period, you will not use the month-to-date totals (except maybe to double check your figures). Instead, from the PROCESS/PAYROLL INTERFACE menu, select <3> SELECT and <4> VOID CHECKS to print those GL transaction registers.

Q. I like to include my void/select checks in the pre-check register to get my FTD amount, but I want a report that shows only the current payroll. Can I do that?

A. Include the voids and selects in the pre-check register that you print before updating the payroll files. Then update the files and print the paychecks. Go back through RESUME and print the pre-check register again, this time

saying **N** to **Include void and select checks?**

Q. Will all of my void and select checks keep accumulating on my pre-check registers?

A. Void and select checks are available to be included **only** in the very next pay period's payroll. So your Totals Page and FTD amount can include only those void and select checks issued since the previous payroll.

And they will be available **only** if you haven't processed end of month/quarter.

Q. How does the general ledger get rid of the voids and selects.

A. Once you create the GL interface file or process end of month/quarter, the general ledger file is cleared and ready to start accumulating the next month's total. Check your printed report carefully before creating the GL interface file.

Q. When I print the pre-check register, I'm always asked if I want to include the void and/or select checks when it's time to print the GL transaction register. If I've already said **Y** to include them in the pre-check register, doesn't that take care of putting them in the GL transaction register automatically?

A. No, you may want them in the FTD but not in the GL transaction register, so *PayMaster* gives you the two separate options: to include or not in the pre-check register and to include or not in the GL transaction register.

Throughout **THE BLUE PAGES**, there are references to payroll tax laws and requirements in effect as of the date specified. These references to the laws and the explanations provided are designed to familiarize the employer with said laws, but are not meant to serve either as a legal or accounting opinion, or as any indication that reference to the Internal Revenue Code or Regulations issued thereunder and appropriate administrative or court rulings interpreting same is unnecessary. All persons using this newsletter should look to and rely upon their respective legal counsel and accountants with respect to these laws and requirements.

User spotlight – The Big Texan Steak Ranch

The Big Texan Steak Ranch in Amarillo, Texas, is a world famous, family-owned restaurant. It's been on Ripley's *Believe It Or Not* TV show and will be featured in the October 2000 movie "Wakin' Up In Reno" starring Billy Bob Thornton and Patrick Swayze.

The Big Texan is famous for its "free" 72 oz. steak dinner – free if you eat the 4½ pound steak, salad, shrimp cocktail, potato and roll in one hour. Almost 35,000 people have tried, and 5,500 have succeeded. Their menu also offers prime Texas beef, buffalo steak, rattlesnake, calf fries, and the popular chicken fried steak.

The restaurant was opened in 1958 by Robert J. Lee, and is now co-owned and operated by the Lee family. Daniel is the Chief Operations Officer and Bob is the Marketing Director. Five of the eight children work in the operations of the restaurant and two others serve on

"... Texas keeps changing the unemployment format for mag media. PayMaster has kept up with every change."

Vera Alcorn
Administrative Assistant
The Big Texan Steak Ranch

the board of directors.

They opened the adjacent Big Texan Inn in 1982. During the warmer seasons, you can enjoy a dip in their pool, heated to 72 degrees and shaped exactly like the Lone Star State. You can brag to the folks back home that you "swam across Texas"!

The Cowboy Palace, a seasonal

facility opened in 1998, is directly behind the Big Texan and features live entertainment and dinner.

In 1985, Administrative Assistant Vera Alcorn, who has worked at the Big Texan for 18 years, went to the National Restaurant Association Show held in Chicago each May. Vera says, "We had bought another payroll program from a company in Georgia. It didn't do tip credit correctly, and it cost more than *PayMaster*! Computer Aid had a booth and Donna Rosen explained how *PayMaster* worked and then went over to the computer and showed me the tip credit on the computer right there. She didn't have to go any further, I ordered the program."

"It handles everything about tips correctly. We use its tip allocation feature, and prepare our form 8027 from *PayMaster*'s data."

Bookkeeper Peggy Sandlin, who has been with the Big Texan for 18 years also, processes payroll and does the payroll tax returns along with Vera.

Peggy says "We used a service before using *PayMaster*. *PayMaster* lets us do payroll in less time and saves us money. Doing payroll ourselves eliminate the long lead time the service requires between the end of the pay period and pay day."

"*PayMaster* is real easy to use – a new person could go through it a couple of times and be ready to do it themselves. Vera and I alternate doing the payroll, so we both know exactly how to do payroll if the other one is out. We both know what reports we need for tax returns. It really helps keep things running smoothly."

Referred to as their "true leaders" by co-owner Dan Lee, Peggy and Vera process payroll for more than 190 employees of the restaurant, the motel, the office, and their catering operation.

Vera says, "We subscribe to AutoUpdate so we can get updates automatically every year. This is good because Texas keeps changing the unemployment format for mag media. *PayMaster* has kept up with every change. When the new hire reporting for child support was



Peggy Sandlin (left) and Vera Alcorn of the Big Texan Steak Ranch

required, we automatically got a *PayMaster* update to print the new report right off the computer."

"The updates are really nice because they enhance what was already there. One of the best added features was the ability to print last quarter tax returns, after the quarter was closed and we had already run a payroll in the next quarter."

"*PayMaster* also helps us get the workers comp auditors out of our office quickly. All they have to do is look at *PayMaster*'s workers compensation reports. We print the one report without tips, showing the compensation wages with the four different rates, for the restaurant, motel, officers, and office. Then since they require us to show wages including tips, we print it from *PayMaster* too. These reports also give us our general ledger workers compensation accruals amounts."

"The phone support is excellent. One time the floppy drive fell on our hard drive and destroyed it. Of course, this happened just as we were getting ready to process payroll. Computer Aid helped us reinstall *PayMaster*

and get our payroll information restored so we could get payroll out in time!” ■

Meet TRAC requirements with help from *PayMaster* and Computer Aid

IRS tip audits

The IRS has lifted their self-imposed moratorium on tip audits and will be auditing restaurants, taxi firms, car washes, and hair salons.

PayMaster's tip report

If your restaurant is audited and the IRS suggests you sign a Tip Reporting Alternative Commitment (TRAC), *PayMaster's* tip report can help you comply with the TRAC requirements.

Build your IRS audit defense!

Order the IRS-produced video “Reporting Tip Income: on TRAC” from Computer Aid. This video is all about reporting tips and the tax law – Who? What? Where? When? and Why? Show it to your directly and indirectly tipped employees when they are hired and replay it periodically for all employees. The video explains to your employees that the law requires them to report all of their tips.

If you’ve signed a TRAC agreement, this helps you comply with the requirement to educate your employees. If you haven’t signed one, you’ll be a step ahead of the IRS. Voluntarily do the things required by law and avoid the need to sign any agreements.

The tape can be ordered from Computer Aid for \$25 plus \$10 shipping and handling.

For more information about *PayMaster's* tip report or to order the IRS video, please call Computer Aid at 800-327-4243.



The IRS wins again!
Please see the front page article.