



# T. Dennis Connally Financial Consultants, Inc.



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## Tips on Tips - A Guide to Tip Income Reporting for Employees who Receive Tip Income

**If you work at a hair salon, barber shop, casino, golf course, airport, hotel, or perform cleaning, food delivery, or taxi cab services, and receive tips, this guide is for you.**

The tip income you receive as an employee from the services such as those listed above—whether cash or included in a charge—is taxable income. As taxable income, these tips are subject to federal income tax, social security and Medicare taxes, and may be subject to state income tax as well.

### **What tips do I have to report?**

#### **Do I have to report *all* my tips to my boss?**

If you received \$20.00 or more in tips in any one month, you should report all your tips to your employer so that federal income tax, social security and Medicare taxes, and maybe state income tax can be withheld.

#### **Do I have to report all my tips on my tax return?**

Yes. All tips are taxable income and should be reported on your tax

return.

#### **I was told that I had to report only a certain percentage of my total sales as tips. Is this true?**

No. You must report to your employer all (100%) tips you receive, except for the tips from any month that do not total at least \$20.00.

#### **Sometimes I don't get tips directly from customers, but rather from another employee. Do I need to report those tips?**

Yes. Employees who receive tips from another employee are required to report "tip-outs." Employees often disburse tips out of their earned tips to another employee (tip-outs).



Remember, all tips are taxable income.

#### **Do I have to report tip-outs that I pay to other employees?**

No. You report to your employers only the amount of tips you retain. However, you must maintain records of tip-outs with your other tip income

(cash tips, charged tips, split tips, tip pool).

### **What records do I need to keep?**

#### **What type of records do I have to keep?**

You must keep a running daily log of all your tip income. You can use Publication 1244, *Employees Daily Record of Tips and Report to Employer*, to record your tip income for one year. Publication 1244 includes Form 4070, *Employee's Report of Tips to Employer*, and Form 4070A, *Employee's Daily Record of Tips*. These forms have spacing for you to log your name, the employer's name and address, date tips were received, date of entry, tips received, tips paid out, and name of employee paid. Your daily log would be your best proof should your income tax return be questioned.

### **What can happen if I don not keep a record of my tips?**

If it is determined in an examination that you underreported your tip income, the IRS will assess the taxes you owe based on the best available records of your employer. Tip income adds up. Underreporting could result in you owing sub-

stantial taxes, penalties, and interest.

**If I report all my tips to my employer, do I still have to keep records?**

Yes. You should keep a daily log of your tips so that in case of an examination, you can substantiate the actual amount of tips received. There are a number of reasons why you might need records:

- Your return could be randomly selected for a federal income tax examination.

For example: Your Form 1040, *U.S. Individual Income Tax Return*, establishes that you have your own home, two cars, and three exemptions, and your Form W-2 shows that you earned only \$10,000 in income. In this scenario, an examination may occur if the examiner determines that income may have been underreported.

- A tip examiner could review your employer's books and records. The examination could reveal unreported tip income that you may later need to verify.
- An Internal Revenue Service Center may run a match of your income information from your Form 1040, *U.S. Individual Income Tax Return*, with the income information from your Form W-2. If these figures do not match, you could receive a notice about the discrepancy and a possible examination of your tax return.

**How does this affect my income filing?**

**I forgot to report my tip income to my employer, but I remembered to record it on my federal income tax return.**

If you do not report your tips to your employer, it places your employer at risk of possible assessment of the employer's share of social security and Medicare taxes.

**If I report all my tips but my taxes on the tips are greater than my pay from my employer how do I pay the remaining taxes?**

You can either pay the tax when you file your federal income tax return or you can reach into your tip money and give some to your employer-to-be applied to those under-withheld taxes. The employer will then record these taxes and you will get credit on your Form W-2. If you wait to pay when you file your return, you may be subject to an estimated tax penalty.



**What can happen if I don't report my tips to the IRS?**

If the IRS determines through an examination that you underreported your tips, you could be subject to additional federal income tax, social security and Medicare taxes, and maybe state income tax. Also, a penalty of 50% of the additional social security and Medicare taxes, and a negligence penalty of 20% of the additional income tax, plus interest, may apply.

**What's in it for me if I report all my tip income?**

There are many good reasons why you want to report all your tip income:

- Increased income may improve financing approval when applying for larger loan amounts (mortgage, car, and other loans)
- Increased worker's compensation benefits, should you get hurt on the job
- Increased unemployment compensation benefits
- Increased social security and Medicare benefits (the more you pay, the greater your benefits)
- Increased employee pension, annuity, or 401(k) participation
- Check with your employer for other increased benefits (based on pay) that your company may offer, such as life insurance, disability

payments, and the right to purchase stock options

- Compliance with the tax law

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**Success**

*"Success is measured not so much by the position that one has reached in life as by the obstacles that one has overcome while trying to succeed."*



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You'll want to consider the strength of your normal backup activities such as making regular backups of your data and maintaining a good paper trail of the important documentation from your systems. You'll also want to consider the frequency of your backups (how often the backups are done) and the storage of backups and paperwork both on-site and off-site just to be safe. This might be a good time to make arrangements to use another organization's work site in case you temporarily experience power outages or hardware and equipment failures. Or you might find other vendors who offer the products and supplies you need if your regular vendors or suppliers are not able to ship products to you.

In short, treating Year 2000 issues as natural disasters and evaluating your disaster recovery plan for your computer systems and other systems may be your best course of action.

**A Final Note**

No one knows for sure what will happen during the Year 2000 rollover, but it's always best to be prepared. We hope our suggestions are useful to you as you make your own plans. After all, the success of your company and your continued business with us is as im-

portant to us as it is to you. This article is not meant to be an extensive road-map on the direction you can take to prepare for the Year 2000. However, we hope it has provided you with some guidelines that can be used as a starting point. It is up to you to assess your company's needs and to choose the best options that will benefit your business in the next century.

*"All of us here at  
T. Dennis Connally,  
Financial Consultant Inc.  
extend to each of you and  
your family  
every good wish for the  
holiday season"*

HERMAN

By Jim Unger



"Let's see. That's 18 volumes of 'Income Tax Made Easy.'"

**NOTICE**

**Credit Policy Change**

**Effective September 1, 1999, any account that is more than 90 days past due will be automatically turned over to our collection service, and the credit bureau will be notified of the delinquent account.**

**TAX TIP**

For the past three years, making investment decisions based upon their income tax consequences has been especially difficult since Congress made surprise changes to the capital gains rules in mid-1997 and mid-1998. There seems to be the potential for more changes in late-1999 in light of the "Taxpayer Refund and Relief Bill of 1999," which was recently passed by Congress. Provisions in this bill would lower the maximum capital gains rate to 18%, effective starting in 1999, and would index the rate for inflation beginning in 2000. Although President Clinton is expected to veto the bill in its present form, passage of the bill does send a signal to taxpayers that a lower capital gains rate is on Congress's agenda, and that rates could very well decrease in the near future. Although we can't predict which proposals become law, it is always a good idea to keep up with potential changes and to understand early in the planning process how they would impact your investment decisions.

**Happy Holidays!**