August 22, 2013

Internal Revenue Service
National Tip Reporting Compliance
3251 North Evergreen Drive, N.E.
Grand Rapids, MI 49525

Dear Sir or Madam:

The National Restaurant Association ("The Association") respectfully submits the following comments pursuant to Internal Revenue Service ("IRS") Announcement 2013-29, 2013-18 I.R.B., entitled Request for Comments on Voluntary Tip Compliance Agreements. Last year, the IRS announced its plan to update its voluntary tip compliance agreements, including the Tip Reporting Alternative Commitment ("TRAC") and the Tip Rate Determination Agreement ("TRDA"). Announcement 2013-29 seeks public comment on possible changes to the IRS’ suite of voluntary tip compliance agreements in an effort to improve employee tip reporting and reduce taxpayer burden.

The Association was established in 1919 and is today the largest foodservice trade association in the world – supporting nearly 500,000 restaurant and foodservice businesses. The restaurant and foodservice industry (The "Industry") employs 13.1 million Americans in 980,000 locations, with 2013 sales expected to reach $660.5 billion. Tips and service charges are customary within the Industry so any changes to IRS compliance programs dealing with the treatment of tips and service charges are important for employers and employees alike. The Association has worked in partnership with the IRS over many years to develop policies that will facilitate voluntary tax compliance in the area of tip reporting. It is through cooperation and collaboration that significant progress has been made to enhance tip compliance.

The Association submits these comments with the goal of working with the IRS and other stakeholders, including the Industry’s payroll service providers and software vendors, to facilitate compliance with the applicable tax laws pertaining to tips and service charges while at the same time mitigating burdens on business owners and employees. As the IRS develops and updates its voluntary tip compliance agreements to help employees accurately report their tip income and to help employers meet their filing and reporting obligations, we ask that you consider the following recommendations:


Enhancing the quality of life for all we serve
Restaurant.org | @WeRRestaurants
2055 L Street NW, Washington, DC 20036 | (202) 331-5900 | (800) 424-5156
Employer Protections from Employer-Only Audits and Assessments of FICA Taxes on Tips – For years, the Association has asked the IRS to include a specific provision in its voluntary tip-reporting agreements granting protection from so-called “employer-only” audits and assessments of FICA taxes on tips, not just from the time of the employer’s entry into and while in a TRAC or TRDA program, but for all years preceding such entry, unless such assessment (Section 3121(q) notice and demand) is based on IRS Form 4137 filed by a tipped employee or IRS Form 885-T prepared by the IRS after an employee tip examination. Under the IRS’ current voluntary tip agreement approach, employers remain unprotected from employer-only FICA tax audits and assessments for years prior to execution of a tip agreement. While the 2002 U.S. Supreme Court decision in Fior d’Italia v. United States, essentially sanctioned the IRS’ interpretation that it has authority under the tax code to issue such Section 3121(q) assessments based solely upon employer tip reporting under IRS Form 8027, a material incentive to employers to sign up for these voluntary agreements would exist if any new tip-reporting agreements included protections for the prior years. The IRS has indicated a willingness to discuss as part of a revision of voluntary tip-reporting agreements that this protection be included in any future tip-reporting agreement. We emphasize this importance and applaud the IRS for their consideration of this new approach.

Employee Protection from Tax Assessments – As the IRS knows, as recognized in all of its previous voluntary tip-reporting agreements, including TRAC and TRDA, employee tip reporting is the heart of the problem. New emphasis is therefore needed in any new voluntary agreement to address not just employer incentives, but also how to incentivize employees to participate and comply with their tip-reporting obligations.

One such approach to incentivize employees that should be considered is to include in any new program tip-audit and tax assessment protections for employees. This could include, for example, protections from tip audits and assessments if they comply with obligations specified under a new agreement both from the time they are in the new program, but also for the years preceding such entry. Such protections will likely prove to be powerful incentives for employees to join any new tip-reporting program and to report all their tips.

Clearer Guidance on the Grounds for Revocation of a TRAC Agreement – Under the existing agreements, the IRS has the authority under certain conditions to revoke the agreement either prospectively or retroactively and, in the case of a retroactive revocation, assess the employer’s share of FICA taxes for earlier years. On behalf of the Industry and particularly those employers currently on TRAC and TRDA, the Association asks that TRAC and the TRDA be amended or any new tip reporting agreement provide a mechanism for a “due process” hearing when the Service is considering a revocation of an agreement. This mechanism would ensure that an IRS determination of TRAC or TRDA or any new agreement compliance or noncompliance is based on uniform principles rather than the revocation being based solely on the IRS field’s presentation of facts or its interpretation of
Facilitate Easy Adoption of TRAC by Establishment – Employers should continue to be able to submit establishments for participation in TRAC or TRDA or any new agreement on an establishment-by-establishment basis. This will allow employers to accommodate or negotiate collective bargaining agreements and to respond to other legal or practical pressures, and operational limitations that affect their establishments differently. It is not clear that an “opt-out” procedure (where all properties are included in TRAC or TRDA or another new agreement unless they are explicitly excluded) would work well. This could put a spotlight on establishments that opt out or could also result in unintended inclusion in the program if an employer inadvertently fails to timely opt out. However, our members do support other means to incentivize and streamline participation in TRAC or TRDA or any new agreement. One such method could be to make available procedures for electronic submission of new establishments with electronic confirmations of receipt, so that applicants are assured of their participation in the program (unless rejected) even if agency officials are not available immediately to personally receive and acknowledge the submissions.

Guidance on How Employers May Suggest Tip Amounts to Customers - It would be helpful for the IRS to provide guidance beyond what it referenced in IRS Rev. Rul. 2012-18 (June 20, 2012) on how restaurants could suggest a tip amount on the customer’s check based on a percentage of the sale without that action being interpreted by the IRS, upon examination, as having converted the suggested tip to a “service charge.” Many restaurants have a practice of suggesting tip amounts (either through sample calculations or insertion of proposed tips on the tip line of the customer’s check) and view this practice as a benefit to employees serving large parties, as a convenience to guests, and as a benefit to the government (due to the increase in tip reporting). It is important to remember that if a suggested tip is legally construed to be a “service charge” rather than a “tip,” it becomes part of the gross receipts of the employer (and taxable as corporate income to the restaurant). Moreover, the employer may not use the service charge amount as a “tip credit” to meet its minimum wage obligations under federal and state wage-hour laws and may not claim a FICA tax tip credit for its share of qualifying FICA taxes under the Internal Revenue Code.

Minimum Tip Rate Declaration for Employees and Employers - Since tip income is taxable, unreported tips can cause big problems for employees and employers. Section 3121(q) makes employers liable for paying the employer share of FICA payroll taxes on unreported tip income upon issuance of a §3121(q) “Notice and Demand.” While the law does not charge the employer with policing employee tip reports nor make the employer responsible for reporting tips by employees, the IRS can still intervene and estimate unreported tips so as to collect back taxes from the employer. Because of this potential
liability, employers may sign a voluntary tip compliance agreement and assume a greater role in employee tip reporting in exchange for audit protection. However, under these tip reporting agreements, employers assume additional costs and burdens. To encourage greater participation in the IRS’ voluntary tip reporting program, especially among small businesses, the IRS should consider establishing a national and/regional and/or state-by-state minimum tip rate. A tip rate set at an appropriate minimum level could serve in any new agreement as protections for both employers and employees from tip audits, and act as another inducement to encourage both employees and employers to participate in the voluntary tip reporting program, encourage greater tip reporting to the IRS, and vastly simplify the program and IRS enforcement procedures.

The Association realizes, of course, that a minimum tip rate raises many potential and complex issues that would need to be examined before any agreement to such an approach is likely to be accepted in the Industry. For example, employee education of their tip-reporting obligations, as now contained under TRAC, would likely still be needed for employees to understand their legal obligations to report all tips. Also, if a minimum tip rate is contained in any new voluntary agreement, this could create employer-employee relations issues if the employer assumes a role of enforcing a minimum tip rate. In addition, an employer attempting to enforce a safe-harbor tip reporting rate for federal purposes could wind up in conflict with federal and state wage-hour laws, which would also need to be considered. Furthermore, a minimum tip rate may also need to be based on market segment, geographic area, hours of service, and other such factors.

Nevertheless, the goal of setting a minimum tip rate in any new agreement would be to provide both employees and employers with audit and tax-assessment protection, and to encourage higher tip reporting. The feasibility of such a concept in our discussions for a new agreement should be considered.

Clarity of Standards Regarding Tips Versus Service Charges - The IRS issued Rev. Rul. 2012-18 to “clarify” and “update” guidelines concerning employment taxes on tips and service charges. The IRS does not represent that Rev. Rul. 2012-18 is new policy and, in fact, the guidelines are generally consistent with the IRS’s characterization and treatment of tips and service charges since 1937. Our members have attempted in good faith to understand and comply with these IRS standards for over seven decades. Employers have longstanding processes and procedures in place, including those memorialized in TRAC, TRDA and other voluntary tip reporting agreements with the IRS. These mechanisms reflect members’ historical technological capabilities to track tips and service charge payments, and their experience with IRS compliance requirements and enforcement standards. To the extent the IRS is placing new, different or enhanced emphasis on the distinction between tips and service charges, perhaps in part because of advances in point of sale technology or the new credit card information reporting requirements, businesses should not be retroactively taxed or penalized. Employers should reasonably be able to
expect that their past capabilities and experience will be respected by the IRS and given adequate time to understand, implement and comply with any changes in IRS policy or enforcement. (See Comments Submitted by the Association to Rev. Rul. 2012-18 http://restaurant.org/Downloads/PDFs/Events-Groups/FINTAX/RevRul201218Comments).

**Establishment of Credit Card Tip Versus Cash Safe Harbor** - To encourage compliance and reduce taxpayer burden, the IRS should consider, in addition to our previous suggestions, establishing a “safe harbor” whereby employees who report cash tips to employers that fall within an appropriate spread between cash and credit/debit card tips is deemed compliant with the rule and their tip-reporting obligations. This simple concept needs to be nuanced to reflect different situations. For example, tip rates for a dinner shift may be substantially different than tip rates for a graveyard shift. A single “cash versus tips” safe harbor seems best designed for a restaurant serving limited day/parts. While the concept may present some complex issues to resolve, we believe it nevertheless should also be explored as part of our discussions.

**Taking Advantage of Improved Point of Sale Systems (POS)** - Since the IRS began offering tip reporting agreements, there have been significant technological advancements with POS systems that might be instrumental in improving employee tip reporting compliance and decreasing taxpayer and administrative burdens. The Association concurs with the IRS that improvements to POS systems may improve the reporting of cash tips, particularly through the tracking of tip-outs, or tip shares distributed to indirectly tipped employees. We look forward to working with the IRS, the payroll industry and software providers to better understand what systems are feasible to implement in a cost effective, non-burdensome manner. It should be noted that some businesses may have external stakeholders (e.g., investors, unions) who may need to be consulted in whether or how to adopt such technology. One potential improvement would be the implementation of a “qualified information systems” safe harbor that would apply for reporting at the end of the shift if the POS system: (1) automatically assigns the employee’s credit card sales and credit card tips; (2) automatically tracks tip-outs (or tip sharing, where permitted) to recipients for proper tip reporting; and (3) automatically assigns employee’s cash sales and then requires the employee to enter cash tips related to cash sales. The potential for a technologically integrated safe harbor would also be an incentive for vendors to develop workable solutions that would meet the new compliance standards.

**Incentives to Encourage Increased Employee Tip Reporting** - Announcement 2013-29 indicates that the new voluntary tip reporting agreements will incorporate a greater

---

1 For example, some food and beverage establishments have a high concentration of business travelers who use credit cards more frequently, and also tip at significantly higher rates than leisure travelers using cash. Therefore, the spread between credit and cash tips may be significantly different than for other establishments. Any safe harbor needs to be flexible enough to take into account these differences.
emph}phasis on accurate tip reporting by indirectly tipped employees. The new agreements will also provide for expedited education requirements for existing employees. There has been some initial discussion with the Service about employee-incentives with regard to tip reporting. For example, is there a way to incorporate “best practices” incentives (currently used by restaurants to encourage employee tip reporting) into a tip agreement? May a restaurant retain a portion of the employees’ tips (without having to negotiate the percentage to be retained on an employee-by-employee basis)? Retained tips may be used for withholdings of income taxes and FICA taxes on tips, so that the employees are not under-withheld on their tip income at year end. For some employers, however, there can be competitive and employee relations obstacles to adopting this strategy, and any such approach must also be balanced as to the U.S. Department of Labor’s interpretation of employer control of tips under wage-hour and garnishment laws in order not to violate these statutory employee rights; as such, perhaps this is best as only an optional rather than required part of any new, revised program.

**Tip-Outs** - Tip-outs is another area where the IRS clearly has concerns and is looking for practices that better track tip-outs to indirectly-tipped staff. Certainly, we want to ensure that any changes to a POS system to track tip-outs to specific employees would be voluntary and would not result in reconciliation issues that would cause the employer to be in noncompliance with the TRAC agreement. This could be an area where our discussions with the IRS may develop a potential alternative.

**Multiple Establishments** - We suggest that employers and their employees be allowed to perform consolidated reporting for all food and beverage establishments located within one facility. For example, some of our members in the hotel and resort industry have several food and beverage establishments at a single property, and their servers may move between two or more of such establishments during a single shift to accommodate the busier establishments. Significant effort and expense is incurred to ensure these servers’ time, sales, and tip information is correctly allocated between the establishments. If hotels could report like most restaurants as single establishments based upon the property location, they can consolidate all of the information at the unit level, thereby reducing the burden and cost, while also increasing accuracy and efficiency, of tip reporting. We also propose exploring the possibility of applying the 8% deemed tip allocation under Treasury Regulation section 31.6053-3(c)(3) on a consolidated basis for multiple establishments at one property or location.

**Consultation with the Department of Labor** - In order to fully understand the legal restrictions on tips, tip reporting, tip credit and tip income, employers must review not only federal tax laws, but also federal and state wage-hour laws. Accordingly, as the IRS contemplates changes to its voluntary tip compliance program, we encourage consultation with the U.S. Department of Labor to minimize differences in interpretation of tip treatment and legal implications by the two agencies. Similarly, it is important to consider
how any revisions to TRAC or TRDA or any new tip-reporting agreement could conflict with state labor laws. States may take a restrictive view on how much an employer can influence tips or tip reporting.

**Conclusion** - A new voluntary tip-reporting program that incorporates concepts discussed above may provide much certainty and incentives for employees to improve employee tip reporting and employers to enter into the IRS’ voluntary tip-reporting agreements. However, these concepts need to be examined and discussed in order to see what could work and what is problematic, all with the objectives of improving employee tip reporting, while at the same time recognizing the need to maintain an even competitive playing field for establishments that may differ significantly in size, market segment, location, staffing levels, etc.

We appreciate the opportunity to provide these comments. The Association looks forward to working in partnership with the IRS and the other stakeholders, including the Industry’s payroll service providers and software vendors, to develop policies and procedures that will facilitate voluntary tax compliance in the area of tip reporting in a fair and effective manner. It might be useful for interested parties (i.e., the Association, IRS, payroll providers, and software vendors) to work together on a suite of new voluntary tip-reporting agreements, which would provide all interested parties an opportunity to make specific recommendations. Absent this arrangement, it would be helpful to release any modified tip-reporting agreements as a Notice with a request for comments.

Sincerely,

David G. Koenig  
Vice President, Tax & Profitability