

IRS Proposes New Program for Service Industry Employers to Avoid Paying Tax on Employee Unreported Tips

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The Internal Revenue Service (IRS) is proposing a new voluntary program, referred to as the Service Industry Tip Compliance Agreement (SITCA) program, for employers in service industries to avoid paying the employer's share of FICA tax on unreported employee tips. See [Notice 2023-13](#). The SITCA program would replace three current programs available to employers in the food and beverage industry and would expand coverage to other service industries, except for the gaming industry. It is designed to take advantage of advancements in Point of Sale (POS) Systems and time and attendance systems, as well as the use of electronic payment settlement methods, to improve tip reporting compliance and to decrease taxpayer and IRS administrative burden.

While employees in all service industries are required to report tip income, the restaurant industry tends to receive the most attention. In restaurants, the wait staff, bartenders, and bussers are required to report their tips, including cash tips, to the restaurant and the IRS. Even if those cash tips are not reported to the restaurant, the IRS can tax the restaurant for the employer's share of FICA tax on the unreported cash tips because tips are compensation income subject to employment tax.

SITCA Would Replace TRAC, TRDA, and EmTRAC

For many years, the IRS has had in place three tip programs for the food and beverage industry designed to relieve the employer of its share of employment taxes on unreported employee tips — the Tip Reporting Alternative Commitment (TRAC) program, the Tip Rate Determination Agreement (TRDA) program, and the Employer-Designed Tip Reporting Program (EmTRAC) — that would be replaced by the SITCA program. The SITCA program would be available to employers in all service industries (excluding gaming industry employers) with at least one business location, called a "Covered Establishment," operating under the Employer Identification Number (EIN) of the employer. The SITCA program is intended to serve as the sole tip reporting compliance program for employers in all service industries (excluding gaming industry employers).

Annual Minimum Reported Tips Requirement

A participating employer would be required to establish *annually* that each of its participating Covered Establishments satisfied a minimum reported tips requirement with respect to its tipped employees. Failure to meet this requirement for a Covered Establishment would cause that Covered Establishment to be removed from the program retroactively to the beginning of that calendar year and it would not be eligible to participate in the SITCA program again for the immediately succeeding three completed calendar years or as otherwise provided by the IRS.

To be compliant with the annual minimum reported tips requirement, the tips reported by tipped employees at each Covered Establishment would have to meet or exceed the sum of –

- all charge tips, as established by the Covered Establishment’s POS System, plus
- an estimation of all cash tips calculated using charge tips and other data from the POS System and applying a minimum charge tip rate as well as applying discount rates for both stiffing and the differential between cash and charge tipping (cash tipping is typically lower).

In calculating the annual estimated amount of all cash tips, the Covered Establishment would use three rates established by the IRS: the SITCA Minimum Charge Tip Percentage, the Cash Differential, and the Stiff Rate. The IRS would calculate these rates using tipping data it collects from service industry establishments and would specify them on its [website](#), which would be updated annually. In an IRS examination of a nationwide restaurant chain, the Employment Tax Specialist reviewed all charge tips for that restaurant and determined the average tip percentage to be 18% (the equivalent of the SITCA Minimum Charge Tip Percentage). He then reduced that amount by 2% for a tip percentage rate for cash transactions because tips on cash transactions are historically lower than tips on credit card transactions (the Cash Differential). He also assumed that no tip would be left for 5% of total cash transactions (the Stiff Rate). Using this information, he determined the amount of unreported cash tips and the employer’s share of the FICA tax attributable to the unreported cash tips.

Requirements for Service Industry Employer and Covered Establishment

To be eligible for the SITCA program, an employer, referred to as a “Service Industry Employer,” would need to meet the following requirements:

- Not be a gaming industry employer;
- Be in a service industry in which employees perform services for customers and those services generate sales that are subject to tipping by customers;
- Have at least one Covered Establishment; and
- Be compliant with Federal, state, and local tax laws for the three completed calendar years immediately preceding the date the application is filed (the preceding period), plus the calendar quarters following the end of the preceding period through any calendar quarters during which the Service Industry Employer’s

application is pending for some or all of the quarter. (A special rule would apply to a SITCA applicant that was not operating as an employer in a service industry for all or part of the preceding period of three completed calendar years.)

After acceptance, Service Industry Employers would be required to constantly satisfy these requirements to continue participating in the SITCA program.

The requirements for each Covered Establishment would be:

- Have tipped employees who utilize a technology-based time and attendance system to report tips; and
- Utilize a POS System to record all sales subject to tipping, and that POS System must accept the same forms of electronic payment for tips as it does for sales.

Participation in the SITCA program would not be based solely on meeting the requirements. The IRS must also determine, in its sole discretion, that acceptance is warranted by the facts and circumstances and is in the interest of sound tax administration. In this regard, SITCA applicants would be required to make certain representations regarding their compliance with Federal, state, and local tax laws. If a SITCA applicant failed to comply with the tax laws, the IRS would have to determine that such failure was due to reasonable cause and not due to willful neglect for the applicant to be accepted.

If a Service Industry Employer were accepted into the SITCA program and added a Covered Establishment later, it could file a request with the IRS to have the additional Covered Establishment included in the program.

Request for Comments

The IRS requests comments on all aspects of the proposed revenue procedure and specifically requests comments on the following issues:

- How a technology-based time and attendance system may be used by tipped employees to report tips, including tips in cash and other forms of tipping made through electronic payments methods (other than a credit card), regardless of whether the tips are received directly from customers or through tip sharing arrangements;
- How tip sharing practices vary across service industries and how the SITCA program can support employer participation while accommodating potential differences in Federal, state, and local labor and employment law requirements; and
- How employers of large food or beverage establishments participating in the SITCA program may meet their filing and reporting obligations under Section 6053(c) of the Internal Revenue Code and also satisfy the SITCA program requirements for compliance while minimizing the administrative burdens on taxpayers and the IRS.

Comments must be received by May 7, 2023.

Practice Considerations

While it seems unfair, the IRS can collect the employer's share of FICA tax on cash tips received by employees even though the employees do not report the tips to the employer. In [*United States v. Fior D'Italia, Inc.*](#), the Supreme Court held that the IRS is authorized to use an aggregate estimation method when a restaurant underreports its tip income and that restaurants could be held liable for taxes beyond what their individual employees reported for tips. The aggregate estimation method uses overall credit card charges to determine the average percentage tip rate paid by the customers. This rate is then applied to the total sales reported to estimate unreported cash tips.

Once the SITCA program is available, employers in the service industry should consider participating. Such participation will provide a level of audit protection for the employer.

Participating will impose some administrative burdens, but these are minimal in comparison to the administrative burden of an employment tax examination on unreported tips. To ensure that the SITCA program is as effective and as administrable as it can be for both the service industry and the IRS, service industry employers should submit comments on the proposed program.

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