



Tip Pooling Tax Implications—What Employers Need to Know

Stuart Simon

The sharing of tips is referred to as “tip pooling,” “tip splitting,” or “tip sharing.” For purposes of this discussion, we will refer to the sharing of tips as tip pooling.

Tip pooling occurs generally in two forms. First, the waiter or other tipped employee receives a tip and the tip is shared with fellow employees, such as bussers, bartenders, runners and hosts. The second form of tip pooling generally is where all employees who receive tips combine their tips and divide the tips among themselves.

The waiter or other directly tipped employee need only include in income the share of tips received, reduced by the payout to the other employees.

However, the other employees receiving the share of tips must report their tips as income. An indirectly tipped employee is treated the same as a directly tipped employee.¹ This is the source of increased reporting and withholding requirements for employers generated by tip pooling.

All employees that receive tips, directly or indirectly, must maintain a daily tip report. The daily reports are maintained on Form 4070A, Employee’s Daily Record of Tips (Form 4070A-PR in Spanish). If the daily tip reports are maintained by the employer in an electronic system, the employee must be given a paper copy.

Note that in situations where there is a mandatory service charge added to a restaurant bill or a catering charge, such as an 18% charge for a party of six or more, that charge is not a tip or gratuity as it is not a voluntary payment. To the extent that all or a portion of the mandatory service charge is distributed to the employees, the amount distributed is reported as payroll, not tips.

Once a month, the directly tipped and the indirectly tipped employees must give the employer a summary of the tip income on Form 4070, Employee’s Report of Tips to Employer. The report is due within 10 days of the month-end. Employees who do not report the tips as required are subject to a penalty equal to 50% of the social security, Medicare, and Additional Medicare taxes due on the tips. The Form 4070 provides for the total cash and credit card tips received by the employee and a deduction

for amounts paid to other employees, arriving at the net tip income.

The employer has a complicated withholding function as the result of tip pooling and the requirement to withhold from both directly tipped and indirectly tipped employees. Once an employee reports the tips to the employer, the tips are treated as wages “paid” by the employer as of the time of the report. The employer must then withhold the income taxes, social security taxes, Medicare taxes and additional Medicare taxes as if the tips were regular wages. However, the employer must withhold only to the extent that he can collect the tax at any time before the end of the year and if the employee’s social security taxes, Medicare taxes and additional Medicare taxes on tips are first deducted in full from such sources. The employer is not required to make up any deficit in withholding other than from funds the employee voluntarily supplies. Any funds the employee voluntarily pays the employer are first applied to the employee’s social security, Medicare or Additional Medicare taxes. The employer must notify the employee if funds under the employer’s control are insufficient to pay the social security, Medicare and Additional Medicare taxes due. The employee will need to pay the amounts directly when the employee files the individual income tax return.

Employee can be given copies of Publication 1244, Employee’s Daily Record of Tips and Report to Employer (which includes the Forms 4070A and Form 4070) for their maintenance of their tip records. If an employer prefers, an electronic system for tips may be maintained by the employer. In any situation, it will be essential that the employer have a method of being sure that employees receiving tips, directly or indirectly, through tip pooling report their tips.

¹ Reg. 31.6053-3(j)(13).
² IRC 3402(k).



Stuart Simon is Of Counsel in the firm’s Tax, Corporate and Real Estate Practice Groups in the Los Angeles office. He can be reached at 213.891.5019 or ssimon@buchalter.com.